

**Directors' duties**

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**Introduction**

**14.1** In this chapter we consider the duties which a director owes to the company. In Chapter 13 we explained that directors are fiduciaries and so much of the case law on their duties is founded on principles originating from the law of trusts and agency. We also saw that the early part of the 20th century marked a significant shift in the way the judges viewed the office of director. In tandem with this development the courts adopted a stricter approach towards the standard of care and skill expected of directors in the performance of their management roles. A concern of both equity and common law courts was to develop a corpus of rules designed to prevent directors abusing their considerable powers. The policy objective is based on prophylaxis and the result is a formidable body of reported decisions in which the judges have been developing the contours of directors' liabilities. In addition to the work of the courts, legislation has also imposed a range of duties, devised principally as reactive measures against specific abuses by directors, particularly in relation to fraudulent asset stripping. Confronted with this considerable body of law, it came as little surprise that the Company Law Review (CLR), in line with its objectives of maximising clarity and accessibility, recommended that the duties of directors should be codified by way of a

statutory restatement. Thus, the 'general duties of directors' now appear in Part 10 of the 2006 Act.

**14.2** By way of background, it is noteworthy that the issue of restating directors' duties in statutory form caused considerable controversy and generated widespread debate. It was a question first considered by the Law Commission and the Scottish Law Commission in their joint report, *Company Directors: Regulating Conflicts of Interests And Formulating A Statement Of Duties* (Nos 261 and 173, respectively). The Law Commissions' examination of directors' duties was already under way at the time of the Government's announcement in March 1998 of the company law review. As part of this wider project the Law Commissions undertook to place their final report before the Company Law Review Steering Group. The Commissions were charged with the objective of determining whether or not the relevant law could be 'reformed, made more simple or dispensed with altogether' (see the Law Commissions Consultation Paper No 153, para 1.7 (the LCCP)). The report was lodged with the CLRSG in July 1999 and informed its deliberations in several key respects.

**14.3** The Law Commissions examined the case for restating directors' duties in statute. Arguments against this were founded on loss of flexibility, while those in favour saw advantages in terms of certainty and accessibility. The Commissions' conclusion was that the case for legislative restatement was made out and that the issue of inflexibility could be addressed by:

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*(i) ensuring the restatement was at a high level of generality by way of a statement of principles; and*

*(ii) providing that it was not exhaustive: i.e. while it would be a comprehensive and binding statement of the law in the field covered, it would not prevent the courts inventing new general principles outside the field.*

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Much of the Law Commissions' joint report is devoted, amongst other things, to achieving the principle of efficient disclosure on the part of directors. The hallmark of their approach is the

emphasis placed on the wider economic context in which company law, particularly that regulating directors, operates. It is asserted that in regulating the enterprise, the law should operate efficiently, promoting prosperity (para 2.8). More particularly, Part 3 of the LCCP recommended that the law ‘should move towards a general principle of meaningful *disclosure*, and that *approval* rules should be seen as the exception’ (Law Com Nos 261 and 173, para 3.72).

**14.4** The proposals put forward by the Law Commissions were broadly endorsed by the CLR. In its *Final Report* (at Chapter 3), the Steering Group recommended a legislative statement of directors’ duties for three principal reasons:

- to provide greater clarity on what is expected of directors and to make the law more accessible. More particularly, it would help to improve standards of governance and provide authoritative guidance and clarification on issues such as ‘scope’—i.e. ‘in whose interests should companies be run?’—in a way which reflects modern business needs and wider expectations of responsible business behaviour;

- to enable defects in the common law to be corrected in important areas where it no longer corresponds to accepted norms of modern business practice;

- to make development of the law in this area more predictable (but without hindering its development by the courts).

The Government accepted these proposals and it is clear that the approach taken by the Law Commissions and the CLR shaped the framing of Part 10 of the 2006 Act. To aid our understanding of the equitable principles which underpin the statutory provisions, we first consider the nature of the fiduciary relationship that exists between a director and the company.

### **The fiduciary position of directors**

**14.5** As we saw in Chapter 13, it has long been settled that directors are viewed as agents of the company and as such they are subject to the full rigour of the fiduciary duties developed by equity to ensure strict compliance with the overriding principle that fiduciaries must not benefit from their position of trust. The classic statement on the position of directors was given by Lord Cranworth LC in *Aberdeen Rly Co v Blaikie Bros* (1854):

*The directors are a body to whom is delegated the duty of managing the general affairs of the company. A corporate body can only act by agents, and it is of course the duty of those agents so to act as best to promote the interests of the corporation whose affairs they are conducting. Such agents have duties to discharge of a fiduciary nature towards their principal.*

**14.6** One consequence of this fiduciary relationship has been the judicial juxtaposition of the terms fiduciary and trustee when referring to the legal status of company directors. In tracing the origins of the director/trustee concept, Sealy (1967) points to the widely held view ‘that the concept had its origin in the fact that, in the earliest companies, the director *was* a trustee in the full technical sense’. Before the modern process of incorporation was introduced most companies were established by a deed of settlement, and the deed almost invariably declared the directors to be trustees of the funds and assets of the business venture (see, for example, *Charitable Corpn v Sutton* (1742)). The courts therefore called directors to account on a trustee basis. In *Re Lands Allotment Co* (1894) Lindley LJ explained that:

*Although directors are not properly speaking trustees, yet they have always been considered and treated as trustees of money which comes to their hands or which is actually under their control; and ever since joint stock companies were invented directors have been held liable to make good moneys which they have misapplied upon the same footing as if they were trustees.*

**14.7** The earliest cases in which the equitable or fiduciary duties were developed relate to the usual 18th and 19th century uses of equity namely, regulating the conduct of trustees of family trusts (see, for example, the leading trust case of *Keech v Sandford* (1726)). Adopting this case law by analogy, the courts used it as the template for framing the fiduciary obligations of directors. However, unlike trustees, directors do not hold the legal title to the property under their control which, as we saw in Chapter 2, belongs to the company as a separate legal person. But, directors are analogous to trustees because they have the duty to manage the company’s affairs in the interest of the company (see *Bairstow v Queens Moat Houses plc* (2001)). As explained by

Mummery LJ in *Towers v Premier Waste Management Ltd* (2011), the fiduciary nature of the office of director can be summed up thus:

*A director of a company is appointed to direct its affairs. In doing so it is his duty to use his position in the company to promote its success and to protect its interests. In accordance with equitable principles the special relationship with the company generated fiduciary duties on the part of a director. His fiduciary commitments to the company took the form of a duty of loyalty and a duty to avoid a conflict between his personal interests and his duty to the company.*

(See, also, the judgment of Norris J in *Breitenfeld UK Ltd v Harrison* (2015)).

Given the wealth of case law which spans almost two hundred years the CLRSG's task of restating it cannot be overestimated. Before examining the duties of directors set out in ss 171–177 of the CA 2006 and related provisions, we begin by addressing the key anterior question, one which was identified by the CLRSG as holding the potential to clarify the scope and nature of the duties generally, namely: to whom are the duties owed?

#### **To whom do directors owe their duties?**

**14.8** Section 170(1) of the CA 2006 provides that the general duties specified in ss 171–177 are owed by a director of a company to the company. The general duties also apply to shadow directors (s 170(5)); it should be noted that s 89(1) of the Small Business, Enterprise and Employment Act 2015 has substituted the original s 170(5) in order to make it abundantly clear (given the conflicting case law) that the general duties do apply to shadow directors, see Chapter 13). A breach of duty is therefore a wrong done to the company and the proper claimant in proceedings in respect of the breach is the company itself (see the rule in *Foss v Harbottle* (1843) and Part 11 CA 2006; Chapter 10). Section 170(1) gives statutory effect to the decision in *Percival v Wright* (1902). The shareholders accepted an offer for the purchase of their shares by the defendants, the directors of the company. The directors had not disclosed that at the time of the purchase they were negotiating with an outsider for the sale of the company's undertaking at a higher price. The shareholders claimed that the defendants stood in a fiduciary relationship with them and the

purchase ought to be set aside for non-disclosure. The court rejected this argument. Swinfen Eady J stressed that to hold otherwise ‘would place directors in a most invidious position, as they could not buy or sell shares without disclosing negotiations, a premature disclosure of which might well be against the best interests of the company’. It should be noted, however, that in reaching its decision the court stressed that there was no unfair dealing by the directors. Further, the fact that the shareholders had themselves first approached the directors requesting the share purchase was material to the court’s deliberations.

(See also, *Multinational Gas and Petrochemical Co Ltd v Multinational Gas and Petrochemical Services Ltd* (1983), in which Dillon LJ explained, that: ‘directors indeed stand in a fiduciary relationship to the company, as they are appointed to manage the affairs of the company and they owe fiduciary duties to the company though not to the creditors, present or future, or to individual shareholders’ (with respect to creditors, see now the proviso in s 172(3) and paras **14.36–14.41**).

It was confirmed by the Court of Appeal in *Hawkes v Cuddy (No 2)* (2009), that the fact that a director was nominated by a shareholder did not, of itself, impose any duty owed to his nominator by the director. A nominee director could take into account the interests of his nominator without being in breach of his duties to the company, provided that his decisions as a director were taken in what he bona fide considered to be in the best interests of the company.

**14.9** To say that directors owe their duties to the ‘company’ is not particularly illuminating. It leaves the key question central to corporate theory unanswered (see Chapter 15). That is, what are the company’s interests? Do the shareholders, as a contractarian analysis would demand, constitute the company’s interests, or is a more pluralist approach adopted by realist theory whereby the company’s interests are aligned with those of the shareholders, creditors, employees, and the general public, correct? The courts have cleverly fudged the answer. In *Greenhalgh v Arderne Cinemas Ltd* (1951) Evershed MR took the view that: ‘the phrase “the company as a whole” does not . . . mean the company as a commercial entity, distinct from the corporators: it means the corporators as a general body’. Thus, he rules out a free floating corporate interest that corporate realists would advocate and identifies the company’s interests with the shareholders as

a general body indicating a contractarian bias. However, that has not been the end of the matter. Detailed consideration was given to the meaning of the ‘interests of the company’ in the Report of the Second Savoy Hotel Investigation (*The Savoy Hotel Ltd, and the Berkeley Hotel Co. Ltd, Report of an Investigation under section 165(6) of the Companies Act 1948* (London, HM Stationery Office, 1954)). There, a Board of Trade Inspector was appointed to report on the legality of the directors’ actions in trying to remove an asset from the company’s control so as to take it beyond the reach of a takeover bidder. The Report considered that it was not enough for directors to act in the short-term interests of the company alone, regard must be taken of the long-term interests of the company. The basis for this is that the duty is not confined to the existing body of shareholders, even future shareholders must be considered (see Grantham (1993)). We return to this issue in relation to s 172 (see para 14.26).

**14.10** Notwithstanding the broad statement of principle by s 170(1) of the CA 2006, there are certain limited circumstances where a special factual relationship can be said to arise between the directors and individual shareholders, for example in takeover situations, where the courts have been prepared to find that ‘fiduciary duties . . . carry with them a duty of disclosure’ to shareholders. For example, it has been held that directors in recommending that a takeover offer should be accepted owe a duty to the shareholders which includes a duty to be honest and not to mislead (*Gething v Kilner* (1972)). This particular situation can of course mean that the ‘future shareholder’ element of the company’s interests is irrelevant. In this regard Lawton LJ in *Heron International Ltd v Lord Grade* (1983) observed that: ‘[W]here the directors must only decide between rival bidders, the interests of the company must be the interests of the current shareholders. The future of the company will lie with the successful bidder’.

**14.11** In the context of a very close family company situations may arise which place directors in a direct fiduciary relationship with the shareholders. In *Coleman v Myers* (1977) the board recommended to the shareholders a takeover offer by a company owned by one of the directors. The New Zealand Court of Appeal, having stressed that *Percival v Wright* (1902) had been correctly decided, found that in a small private domestic company where the shares were

concentrated in the hands of a few family members, a duty of disclosure arose which placed the directors in a direct fiduciary relationship with the shareholders. (See also *Re Chez Nico (Restaurants) Ltd* (1992), Browne-Wilkinson V-C; cf *Sharp v Blank* (2015), Nugee J. In effect in this context the directors were treated as agents of the shareholders and not the company. Commenting on Browne-Wilkinson V-C's observations in the *Re Chez Nico* case and on the decision in *Coleman v Myers* (1977), David Mackie QC (sitting as a deputy judge in the High Court) in *Platt v Platt* (1999) stressed that:

*[t]hese are, however, cases of the highest persuasive authority and . . . plainly right. Accordingly, the fact that the relationship between director and shareholder does not of itself give rise to a fiduciary duty does not prevent such an obligation arising when the circumstances require it. In so far as Percival v Wright (1902) indicates otherwise this is only because of the significance attached to the headnote which . . . is broader than is justified by the underlying decision.*

(See also *Glandon Pty Ltd v Strata Consolidated Pty Ltd* (1993); and *Brunninghausen v Glavanics* (1999).)

**14.12** It would be stretching these decisions too far to conclude that directors owe a parallel fiduciary duty to shareholders. What they show is that where 'directors take it upon themselves to give advice to current shareholders . . . they have a duty to advise in good faith and not fraudulently, and not to mislead whether deliberately or carelessly' (*Dawson International plc v Coats Patons plc* (1989), Lord Cullen). This apart, Lord Cullen stressed that 'directors have but one master, the company'. The resonance of Lord Cullen's view is clearly evident in the approach adopted by Neuberger J in *Peskin v Anderson* (2000), which was affirmed by the Court of Appeal. The dispute arose out of the demutualisation of the Royal Automobile Club (RAC) in which the members at the time of the sale received substantial payments. Former members of the club claimed that the directors were in breach of fiduciary duty in failing to disclose their plans to demutualise. They argued that had they known of the proposal they would have been able to make a properly informed choice as to whether to remain members. The judge, dismissing the claims,

held that the directors did not owe any fiduciary duty to the members who had terminated their membership of their own motion when no specific proposal was in contemplation. The judge stated:

*I am satisfied, both as a matter of principle and in light of the state of the authorities, that Percival v Wright is good law in the sense that a director of a company has no general fiduciary duty to shareholders. However, I am also satisfied that, in appropriate and specific circumstances, a director can be under a fiduciary duty to a shareholder. To hold that he has some sort of general fiduciary duty to shareholders (a) would involve placing an unfair, unrealistic and uncertain burden on a director and (b) would present him frequently with a position where his two competing duties, namely his undoubted fiduciary duty to the company and his alleged fiduciary duty to shareholders, would be in conflict.*

**14.13** Apart from restating the common law in s 170(1), the provision goes on to address a range of issues that came to light during the various consultation exercises on whether or not the Act should set out in the form of a restatement the general duties of directors. A point of contention that emerged during both the Law Commissions and the CLR's consultations was whether the statutory statement of duties should be exhaustive. Section 170(3) attempts to settle the matter in two ways. First, it provides that the general duties are based on certain common law rules and equitable principles governing the behaviour of directors. Secondly, it states that the statutory restatement shall have effect in place of those principles. Indeed, even in current litigation where the events in issue may have occurred before Part 10 of the 2006 Act entered into force, the statutory language will nevertheless influence the approach of the courts. In *Towers v Premier Waste Management Ltd* (2011), Mummery LJ observed that:

*I have described the equitable principles and duties in the past tense because, under the codification measures in Chapter 2 of the Companies Act 2006, a director's general duties to the company are now statutory. The codified duties are expressly derived from common law rules and equitable principles as they apply to directors. The relevant events in this litigation occurred in 2003, well before those provisions of the 2006 Act*

*were brought into force. Although the pre-2006 Act common law rules and equitable principles continue to apply to a pre-2006 Act case, it is unrealistic to ignore the terms in which the general statutory duties have been framed for post-2006 Act cases. They extract and express the essence of the rules and principles which they have replaced.*

Section 170(3) has to be read together with s 170(4) which directs the courts to interpret and apply the general duties having regard to the pre-existing case law and thus the significant body of jurisprudence surrounding directors' duties is by no means redundant. In *Eastford Ltd v Gillespie* (2010), Lord Hodge, considering s. 170(4), observed that it:

*seeks to address the challenge which the Law Commissions and the Company Law Review had identified, namely of avoiding the danger that a statutory statement of general duties would make the law inflexible and incapable of development by judges to deal with changing commercial circumstances. Parliament has directed the courts not only to treat the general duties in the same way as the pre-existing rules and principles but also to have regard to the continued development of the non-statutory law in relation to the duties of other fiduciaries when interpreting and applying the statutory statements. The interpretation of the statements will therefore be able to evolve.*

Taking these two subsections together, some doubt remains over the extent to which the restated duties merely replicate or, indeed, replace the pre-existing duties: for example, it will be seen that the duties of directors encapsulated in ss 175 and 176 (respectively, the no-conflict duty and the prohibition against accepting benefits from third parties) are not framed so as to reflect precisely the applicable equitable principles and terminology found in the case law. Such uncertainty runs counter to the declared objectives of the CLR to provide greater clarity on what is expected of directors and to make the law more accessible. On the other hand, in the interests of clarity, s 170(2) does restate the point that emerges from the case law that the duties encompassed in ss 175 and 176 continue to apply after a person ceases to be a director:

- (a) as regards the exploitation of any property, information, or opportunity of which he became aware at a time when he was a director (duty to avoid conflicts of interests), and

(b) as regards things done or omitted by him before he ceased to be a director (duty not to accept benefits from third parties).

(See *Safetynet Security Ltd v Coppage* (2012) in which the court applied s 170(2) in holding a former director liable for breaches of the no-conflict rule.)

Finally, it is also noteworthy that s 179 states that, except as otherwise provided, more than one of the general duties may apply in any given case. The duties are thus cumulative. Depending on the particular circumstances, directors may, therefore, be liable under one or more of the provisions contained in Part 10 of the Act.

### **The general duties of directors: CA 2006, Part 10**

#### **(i) Duty to act within powers**

**14.14** Section 171 of the CA 2006 provides that a director of a company must—

- (a) act in accordance with the company's constitution, and
- (b) only exercise powers for the purposes for which they are conferred.

Part (a) of s 171 restates the common law principle that directors must act within the limits of the company's constitution which is defined by s 17 as including the company's articles and any shareholder resolutions and agreements (see further, Chapter 8). Part (b) restates the so called 'proper purposes doctrine' formulated by Lord Greene MR in *Re Smith & Fawcett Ltd* (1942), in which he explained that:

*[Directors] must exercise their discretion bona fide in what they consider—not what a court may consider—is in the interests of the company, and not for any collateral purpose.*

There are two limbs to Lord Greene's statement of the duty. The first relates to good faith which falls within the scope of s 172 (see later), while the duty not to act for a collateral purpose is encompassed in s 171. The two elements are distinct duties (*Bishopsgate Investment Management Ltd v Maxwell* (1993)), and it is logical that they should be accorded separate provision in the Act.

**14.15** The proper purposes doctrine has frequently been applied, although not exclusively, in relation to the power to issue shares; an obvious consequence of which is that the voting rights of an existing majority shareholder may be adversely affected. While a majority shareholder or controlling

interest does not have a right of property to prevent a further allotment of shares being made, such a shareholder is entitled to demand that the power be exercised lawfully. Share issues aside, the application of the doctrine arose in *Extrasure Travel Insurances Ltd v Scattergood* (2002) which concerned the power of directors to deal with corporate assets. The directors of Extrasure had transferred company funds, some £200,000, to another company in the group, Citygate Insurance Brokers Ltd (the parent company), to enable it to pay a creditor who had been pressing for payment. One of the arguments put forward by the claimant was that the directors had exercised their powers for an improper purpose.

**14.16** There is an overlap between the duty of good faith (now contained in s 172 (see later): duty to promote the success of the company) on the one hand, and the proper purposes doctrine in s 171 on the other, in so far as the latter operates to limit the authority of directors even if their action was carried out in what they bona fide believed to be in the best interests of the company. If a power is exercised primarily for some collateral purpose (which is objectively determined as a matter of construction of the articles), the directors are guilty of an abuse of power and their action can be set aside. Thus, for example, while the directors may believe it is in the best interests of the company to defeat a takeover by allotting shares to shareholders who they trust in order to reject the bid, that will probably be viewed as an improper exercise of the power to allot shares as it was originally conferred to raise capital: not to increase the voting rights of certain shareholders for some collateral purpose. As was pointed out by Wilson J in *Whitehouse v Carlton Hotel Pty* (1987), it is ‘no part of the function of directors as such to favour one shareholder or group of shareholders by exercising a fiduciary power to allot shares for the purpose of diluting the voting power attaching to the issued shares held by some other shareholder or group of shareholders’. The interplay between ss 171 and 172 was recently explained by Mann J in *Eclairs Group Ltd v JKX Oil & Gas plc* (2013), discussed more fully later. The judge said that s 172 is an ‘overarching obligation which arises when directors are considering the exercise of powers.’ He went on to state that s 172 does not ‘trump’ s 171:

*In relation to any given power, it is necessary to identify the purposes for which the power*

*is exercised . . . and having identified that purpose one then has to see whether the directors have exercised it for that purpose, and also whether it was exercised so as to 'promote the success of the company.'*

**14.17** As seen, the duty evolved out of disputes in which it was typically argued that the power to issue shares is conferred on directors in order to raise capital for the company and that a share allotment for any other purpose is necessarily improper. For example, in *Hogg v Cramphorn* (1967) a share allotment was held invalid notwithstanding that the directors had acted in good faith on the basis that their primary motive was to forestall a takeover bid and remain in control. Another clear illustration of self-interest being the principal motivating factor in the exercise of the power to issue shares is afforded by *Piercy v S Mills & Co Ltd* (1920). The directors allotted shares although the company was not in need of additional capital. The court held, setting aside the allotment, that this was done 'simply and solely for the purpose of retaining control in the hands of the existing directors'.

**14.18** A thorough analysis of the proper purposes doctrine was undertaken by Lord Wilberforce in the Privy Council decision in *Howard Smith Ltd v Ampol Petroleum Ltd* (1974). Two shareholders, Ampol Ltd and its associated company 'Bulkships', held 55 per cent of the shares in R W Miller (Holdings) Ltd. Ampol and Howard Smith made rival takeover offers for Miller. Preferring the latter's bid because it was more generous than Ampol's, and because they believed that the long-term future of the company would be more secure in its hands, Miller's directors issued shares to Howard Smith which had the effect of diluting Ampol's shareholding from 55 per cent to 36 per cent. Ampol sought a declaration that the share allotment was invalid as being an improper exercise of power. The directors contended that the allotment was made primarily in order to obtain much needed capital for the company.

Both at first instance and on appeal it was accepted that the directors were not motivated by self-interest. However, it was held that the share allotment was not made to satisfy Miller's need for further capital but to destroy Ampol's majority shareholding in the company. The share issue was therefore invalid.

**14.19** Lord Wilberforce stated that when the exercise of a particular power is challenged, the determination of whether or not it had been exercised for an improper purpose is a twofold process. First, it is necessary to consider the power in question in order to ascertain, ‘on a fair view’, its nature and the limits within which it may be exercised. Second, the substantial purpose for which the power was exercised should be examined so as to determine whether that particular purpose was proper or not. The court ‘will necessarily give credit to the *bona fide* opinion of the directors, if such is found to exist, and will respect their judgement as to matters of management; having done this, the ultimate conclusion has to be as to the side of a fairly broad line on which the case falls’. Although the court will not challenge the commercial judgement of the directors nevertheless in relation to the second stage, i.e. determining the substantial purpose for the particular exercise of a power, Lord Wilberforce stressed that it is entitled to take an objective approach in order to estimate how critical or pressing, or substantial or, per contra, insubstantial an alleged requirement may have been. In this regard, Kirby P explained in *Advance Bank of Australia Ltd v FAI Insurances Australia Ltd* (1987), that:

*statements by directors about their subjective intention, whilst relevant, are not conclusive of the bona fides of the directors or of the purposes for which they acted as they did. In this sense, although the search is for the subjective intentions of the directors, it is a search which must be conducted objectively as the court decides whether to accept or discount the assertions which the directors make about their motives or purposes.*

On the facts of *Ampol Petroleum*, the Privy Council concluded that:

*Just as it is established that directors, within their management powers, may take decisions against the wishes of the majority of shareholders, and indeed that the majority of shareholders cannot control them in the exercise of these powers while they remain in office (Automatic Self-Cleansing Filter Syndicate Co Ltd v Cunninghame [earlier]), so it must be unconstitutional for directors to use their fiduciary powers over the shares in the company purely for the purpose of destroying an existing majority, or creating a new majority which did not previously exist. To do so is to interfere with that element of the*

*company's constitution which is separate from and set against their powers.*

Therefore, it is not sufficient for directors to act in what they believe is in the best interests of the company unless they can also establish that their actions are within the scope of the powers conferred on them.

More recently, the determination of the proper purposes rule came to the fore in the Supreme Court decision in *Eclairs Group Ltd v JKX Oil & Gas plc* (2015). The issue here centred on the power of directors, conferred by ss 793–797 CA 2006, to issue a disclosure notice calling for information about persons interested in its shares. In the event of non-compliance, the company can apply to the court to restrict the exercise of rights attaching to the shares. Additionally, the articles of JKX Oil and Gas plc (JKX) also included the common provision that the board could treat a response to a disclosure notice as non-compliant where there was reasonable cause to suspect that the information provided was false or otherwise materially incorrect (art 42). The articles also provided for the restrictions that the company itself could impose on a shareholder for non-compliance, which included disenfranchising those shares at company general meetings. In brief, the case involved a ‘corporate raid’ on JKX which, as noted by the Supreme Court, was ‘an attempt to exploit a minority shareholding in [the] company to obtain effective management or voting control without paying what other shareholders would regard as a proper price.’ The minority shareholding, some 39 per cent of JKX’s shares, was held by two companies incorporated in the British Virgin Islands which were controlled by Ukrainian businessmen: Eclairs Group Ltd and Glengary Overseas Ltd. The directors of JKX suspected these companies of mounting a corporate raid and therefore issued a number of s 793 notices on Eclairs and Glengary. Believing that the responses to the notices fell short of the information requested, JKX’s directors used their powers under the constitution to stop Eclairs and Glengary from voting at the 2013 AGM where the two companies were opposing resolutions proposed by JKX’s board.

Eclairs and Glengary challenged this exercise of power. The trial judge, Mann J, held that their disenfranchisement was invalid on the basis that the JKX board had been motivated by improper purposes: the purposes of the board’s decision included a desire to interfere with voting control in

order to ensure that various AGM resolutions were passed. The judge reasoned that any restrictions imposed by the directors in response to a failure to provide information had to be for the purpose of eliciting that information. Accordingly, the restrictions, being tainted by improper purposes, were invalidated. Taking a purposive view of ss 793–797, the judge said:

*[The directors] took the opportunity of using the power to alter the potential votes at the forthcoming AGM in order to maximise the chances of the resolutions being passed in a manner which they thought was in the best interests of the company. I do not doubt the genuineness or reasonableness of their belief as to what was in the best interests of the company. However, what they did was to use a power given for a limited purpose, related to a failure to give proper information in response to a s 793 notice, and then to apply it for another, namely to stop shareholders voting so that the rights of shareholders could be successfully changed (and directors defended, though as it happened the latter would have happened anyway). That contravenes the basic provision that powers are to be exercised for the purposes for which they are given. The purposes of the majority of the directors had this impermissible purpose as a substantial, if not a principal, purpose of their exercising the power, notwithstanding that they may have had at least half an eye to the obtaining of information. Most of the directors gave far more importance to the advantage per se of getting their resolutions through than they did to the obtaining of the information.*

JKX's appeal was successful. The Court of Appeal took the view that provided the board had reasonable grounds to believe that the required information had not been furnished, it could impose the restrictions provided for in the relevant article—and the purpose underlying the imposition was irrelevant. Sir Robin Jacob and Longmore LJ, delivering a joint judgment which sought to identify the legislative intent behind the relevant statutory provisions (Briggs LJ dissenting), observed:

*The 2006 Act does not specify that the sanction of restrictions on voting can only be imposed for any particular purpose. We find it difficult to believe that Parliament intended a detailed inquiry into the minds of the directors of a company to be undertaken*

*before the sanction can be imposed. . . . Section 800(3) of the 2006 Act make clear that, once imposed, the sanction cannot be released except in the circumstances there specified. Absence of dominant purpose of obtaining the information is not there specified. If all (or a majority of directors) have to give evidence of their dominant purpose in imposing the relevant sanction and be prepared to submit to cross-examination, it is difficult to see how s 793 of the 2006 Act can function in what may often be a rapidly changing scene. It is much more likely that Parliament intended that the relevant sanction be imposed (and remain imposed) while no or incorrect information is given.*

*This construction moreover gives substance to the 2006 Act or an article such as Art 42. For in reality it is precisely the circumstances of this sort of case where the section (or an article such as Art 42) is most likely to be invoked . . . The result is that if the predominant motive test applies the provisions would be unlikely to have any or much application: they would be emasculated.*

*We think that any other construction of the section (or in this case JKX's Articles) would only be an encouragement to deceitful conduct and not something which English company law should countenance.*

The Supreme Court, however, unanimously disagreed. Restoring the decision of Mann J, it held that the proper purposes rule did apply to the exercise of the power by JKX's board, and it had been breached. In its view, there are three purposes underlying the power to restrict the rights of shareholders who fail to comply with a s 793 notice:

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- (i) to induce a shareholder to comply with a disclosure notice;*
- (ii) to protect the company and its shareholders against having to make decisions about their respective interests without having relevant information; and*
- (iii) as a punitive sanction for failure to comply with a disclosure notice.*

<Extract Close>

As Lord Sumption explained in the clearest of terms, seeking to control the outcome of shareholders' resolutions forms no part of those proper purposes: 'there is in principle a clear line between protecting the company and its shareholders against the consequences of non-provision of the information, and seeking to manipulate the fate of particular shareholders' resolutions or to alter the balance of forces at the company's general meetings. The latter are no part of the purpose of article 42. They are matters for the shareholders, not for the board.'

The members of the Supreme Court expressed different views on the application of the proper purposes rule in cases where directors exercise their powers for mixed purposes (as in *Howard Smith*)—'some good, some bad' (citing *Buckley on Companies*). In the absence of oral or written submissions, Lord Mance stressed that the court should not express any concluded views on points which do not arise for decision in the present appeal. However, he went on to say that he would have welcomed submissions on the scope of s 171(b) in order to clarify its meaning given that the section states that directors may use their powers 'only' for the purposes for which they were conferred. For Lord Mance, this is clear: '[A]ll purposes in mind must be legitimate.' But, he notes, that *Buckley* suggests that it itself involves a primary purpose test as held in *Howard Smith* (noting that by virtue of s 170(4), the common law should inform the construction of s 171(b)), so that where directors exercise a power with mixed motives, the court will seek to determine the principal purpose of their conduct (and if that is found to be improper, the exercise of the power in question will be voidable (see, *Bamford v Bamford* (below))). In other words, construing s 171(b) in line with the pre-existing case law means 'that a director must exercise his powers primarily (or substantially) only for the purposes for which they are conferred.'

In the light of this uncertainty over the scope of the statutory duty and the appropriate test to be applied where directors have multiple concurrent purposes for exercising a power in a particular way, Lord Sumption expressed the view (with which Lord Hodge agreed) that a 'but for' test of causation should be applied. In support of this opinion, Lord Sumption relied on *Whitehouse v Carlton* (see para 14.16), in which High Court of Australia stated:

*As a matter of logic and principle, the preferable view would seem to be that, regardless of*

*whether the impermissible purpose was the dominant one or but one of a number of significantly contributing causes, the allotment will be invalidated if the impermissible purpose was causative in the sense that, but for its presence, the power would not have been exercised.*

Thus, the court would need to determine whether or not the same decision would have been made by the directors if there had not been any improper purpose at play. Lord Mance, in the majority, expressed his sympathy with Lord Sumption's reasoning that 'but for causation offers a single, simple test which it might be possible or even preferable to substitute for references to the principal or primary purpose', but felt that this important question must be left undecided having not heard argument on the point.

**14.20** Returning now to other facets of the proper purposes rule that have been addressed by the courts over the years, it was long thought that the effect of an improper exercise of power was to render the director's conduct capable of ratification by the company in general meeting. In *Hogg v Cramphorn*, the Court of Appeal declined to set a disputed allotment aside until a general meeting of the company, as it was before the disputed share issue was made, had had the opportunity to either approve or disapprove of the share issue. In fact the directors' conduct was duly ratified by the company. This was followed in *Bamford v Bamford* (1970). However, in *Re Sherborne Park Residents Co Ltd* (1987) a shareholder petitioned the court under s 459 (now CA 2006, s 994, the unfair prejudice provision, see Chapter 11) in order to restrain an allotment of new shares which would alter the balance of power in the company. The court took the view that the petitioner's complaint was not that a wrong had been done to the company but that his personal rights qua shareholder had been infringed. Although the alleged breach of duty might in theory be a breach of duty owed to the company, Hoffmann J held that in substance it was an infringement of a shareholder's contractual rights under the articles of association. On this analysis the issue of ratification by the general meeting of the directors' conduct does not arise since a member will have a personal cause of action.

**14.21** There is clear and obvious merit in Lord Mance's call for a definitive determination of the scope of

s 171(b). But pending future judicial resolution of the questions raised by the Supreme Court in *Eclairs Group Ltd* about the test for determining breach of s 171(b), what seems settled for the time being is that *Howard Smith* should not be taken as holding, without more, that directors can only legitimately exercise the power to issue shares in order to raise additional capital. Nor should it be simply construed as laying down an absolute prohibition against directors issuing shares to change the balance of control of the company. In this regard, the High Court of Australia has acknowledged that the power to issue shares may be exercised for reasons other than the raising of capital provided ‘those reasons relate to a purpose of benefiting the company as a whole, as distinguished from a purpose, for example, of maintaining control of the company in the hands of the directors themselves or their friends’ (*Harlowe’s Nominees Pty Ltd v Woodside (Lake Entrance) Oil Co* (1968); see also *Mutual Life Insurance Co of New York v Rank Organisation Ltd* (1985)):

*If Company A and Company B are in business competition, and Company A acquires a large holding of shares in Company B with the object of running Company B down so as to lessen its competition, I would have thought that the directors of Company B might well come to the honest conclusion that it was contrary to the best interests of Company B to allow Company A to effect its purpose . . . If, then, the directors issue further shares in Company B in order to maintain their control of Company B for the purpose of defeating Company A’s plans and continuing Company B in competition with Company A, I cannot see why that should not be a perfectly proper exercise of the fiduciary powers of the directors of Company B. The object is not to retain control as such, but to prevent Company B from being reduced to impotence and beggary, and the only means available to the directors for achieving this purpose is to retain control. This is quite different from directors seeking to retain control because they think that they are better directors than their rivals would be (*Cayne v Global Natural Resources plc* (1984) per Sir Robert Megarry V-C).*

**14.22** In *Teck Corpn Ltd v Millar* (1972), noted by Lord Wilberforce in *Howard Smith* as being a

decision in line with English and Australian authority, the British Columbia Supreme Court held that an allotment of shares designed to defeat a takeover was proper even though it was made against the wishes of the existing shareholder and deprived him of control. Berger J criticised *Hogg v Cramphorn* as laying down the principle that directors have no right to issue shares in order to defeat a takeover bid even if they consider that in doing so they are acting in the company's best interests. He took the view that this was inconsistent with the law as laid down by Lord Greene MR in *Re Smith & Fawcett Ltd*. Berger J stressed that directors are entitled to consider the reputation, experience, and policies of anyone seeking to take over the company and to use their power to protect the company if they decide, on reasonable grounds, that a takeover will cause substantial damage to the company. Declining to follow *Hogg v Cramphorn*, he reasoned:

*How can it be said that directors have the right to consider the interests of the company, and to exercise their powers accordingly, but there is an exception when it comes to the power to issue shares, and that in the exercise of such power the directors cannot in any circumstances issue shares to defeat an attempt to gain control of the company?*

The judge concluded that directors must act in good faith and must have reasonable grounds for their belief. The absence of reasonable grounds will 'justify a finding that the directors were actuated by an improper purpose'. Citing *Australian Metropolitan Life Assurance Co Ltd v Ure* (1923), Berger J said that the onus of proof is on the person challenging an exercise of power. On the particular facts of *Teck* it was held that 'the plaintiff has failed to show that the directors had no reasonable grounds for believing that a takeover by Teck would cause substantial damage to the interests of [the company] and its shareholders'.

**14.23** The tests for determining whether or not a power has been exercised for an improper purpose came to the fore in *Extrasure Travel Insurances Ltd v Scattergood* (see para **14.15**). Jonathan Crow QC, sitting as a deputy judge of the High Court, stated that:

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*The law relating to proper purposes is clear, and was not in issue. It is unnecessary for a*

*claimant to prove that a director was dishonest, or that he knew he was pursuing a collateral purpose. In that sense, the test is an objective one. It was suggested by the parties that the court must apply a three-part test, but it may be more convenient to add a fourth stage. The court must:*

- 1. identify the power whose exercise is in question;*
- 2. identify the proper purpose for which that power was delegated to the directors;*
- 3. identify the substantial purpose for which the power was in fact exercised; and*
- 4. decide whether that purpose was proper.*

<Extract Close>

Applying this four-part test to the facts, the judge reasoned that the power in question was the directors' ability to deal with the assets of Extrasure in the course of trading. He noted that the purpose for which that power was conferred on the directors was broadly to protect Extrasure's survival and to promote its commercial interests in accordance with the objects set out in its memorandum. Finding that the defendants' substantial purpose in making the transfer was to enable Citygate to meet its liabilities, not to preserve the survival of Extrasure, the judge concluded that the purpose for which the transfer was made was plainly an improper one. There appears to be nothing in the views expressed by the majority in the Supreme Court in *Eclair's Group* (see para **14.19**) that would challenge the judge's approach here.

The proper purposes doctrine as manifested in the second limb of s 171 was considered in *West Coast Capital (Lios) Limited* (2008), by the Court of Session. Tesco Holdings Ltd was prevented from obtaining complete control of Dobbies Garden Centres plc, in part, because a rival bidder, West Coast Capital (WCC), purchased shares in the market at above the offer price. Although Tesco achieved a 65 per cent holding, WCC remained a significant minority shareholder. The new board of Dobbies announced that it would not be paying dividends and proposed to raise £150 million by way of an issue of new shares. WCC petitioned under s 994 of the CA 2006 (the unfair prejudice provision, see Chapter 11), on the basis that it was highly unusual for companies to cease to pay dividends when they have not suffered a poor operating performance and so the court

should ‘infer a sinister intent’ in this regard. WCC also argued that the current directors consistently exercised their powers in Tesco’s interests to the prejudice of other shareholders, including themselves, rather than for the purposes for which those powers were conferred and the proposed share allotment made no commercial sense. On the evidence, the petition was unsuccessful. However, for our current purposes, the observations of Lord Glennie about s 171 are of particular interest. He noted that the statutory provision did little more than set out the pre-existing law. Citing *Howard Smith Ltd v Ampol Petroleum Ltd*, it was accepted by the court that the test under s 171(b) was subjective and that it was necessary to consider the actual motivation of the directors. The judge concluded the point thus:

*The test . . . is essentially one of looking at the purpose or purposes for which the directors were exercising their powers, i.e. their motivation. If an improper motivation can be shown, if only by inference from an objective assessment of all the surrounding circumstances, the basis of [liability] . . . might be established.*

**14.24** An unusual illustration of improper purposes, at least in so far as Hart J, at first instance, and the Court of Appeal were concerned, arose in relation to so-called ‘poison pill’ arrangements in *Criterion Properties plc v Stratford UK Properties LLC* (2004). While such arrangements are extremely rare in the UK (indeed, *The Takeover Code* prohibits action by the board of directors of an offeree company which might frustrate a bona fide offer for the company (see General Principle 7, and Rule 21)), they are commonly encountered in North American jurisdictions. In essence a poison pill is a mechanism designed to deter hostile takeovers by making the target company unattractive. Typically a poison pill, also known as a shareholder rights plan, is used to prevent corporate raiders from gaining control by making it prohibitively expensive for the raider to acquire sufficient interest in the target company to gain control over it. This is achieved in numerous ways. Commonly, it is done by diluting the acquiring company’s interest in the target company or by allowing target shareholders to buy shares in the acquiring company at bargain prices (for a full examination of poison pills, see Lowry (1992)). In *Criterion Properties plc v Stratford UK Properties LLC*, two companies, Oaktree (O), an American company, and Criterion

(C), a UK company, were parties to a joint venture for investment in real property. They entered into a supplementary agreement intended to protect C against takeover and change of management by what is termed a ‘poison pill’ arrangement. Its effect was to give O the right to have its interest in the joint venture bought out at a very favourable price (i.e. above market valuation) should another party gain control of C or in the event of N or G ceasing to be directors or employees or involved in the management of C. This agreement achieved its objective of deterring a takeover. Subsequently, the parties began negotiations to rescind it. These broke down and C brought an action to have the agreement set aside. The Court of Appeal upheld Hart J’s finding that the supplementary agreement was an improper use of the directors’ power to bind C because, unlike the authorities we have considered, this agreement:

*involved not the issue of shares, but the gratuitous disposition of the company’s assets . . . The buyback provision could be triggered by any takeover, not only by a hostile predator, but even one regarded as wholly beneficial . . . Furthermore, it could be triggered by the departure of N or G, even in circumstances which had nothing to do with a change of control, for example, death or dismissal due to misconduct.*

While the Court of Appeal’s analysis of the purpose behind the exercise of the power in question is of interest, it should be noted that the House of Lords approached the issue on the basis of directors’ authority, i.e. whether the directors had actual, apparent, or ostensible authority to sign the agreement (see further Chapter 12). Since this could not be decided on the evidence available, the case was remitted for trial.

**14.25** Directors frequently have an interest as shareholders in the company, and the courts recognise that in promoting the interests of the company they will also necessarily promote their own interests. In this regard a realistic view is taken that does not require ‘detached altruism’ on the part of directors, so that in determining whether they have acted in the best interests of the company or for some improper purpose, the test is ‘[W]hat was “the moving cause” of the action of the directors?’ (*Mills v Mills* (1938), Latham CJ citing Lord Shaw in *Hindle v John Cotton Ltd* (1919)). Thus, the fact that a director derives some incidental benefit from the action taken will not in itself mean that

the fiduciary duty has been broken (*Madden v Dimond*; *Rudolf v Macey* (1905), Martin J). The appropriate test in such circumstances seems to be along the lines of the ‘but for’ test of causation familiar to tort lawyers. In *Mills v Mills* (1938), the court upheld a resolution to distribute bonus shares even though it had the effect of consolidating the majority voting power of the company’s managing director. Dixon J said:

*but if, except for some ulterior and illegitimate object, the power would not have been exercised, that which has been attempted as an ostensible exercise of the power will be void, notwithstanding that the directors may incidentally bring about a result which is within the purpose of the power and which they consider desirable.*

**(ii) Duty to promote the success of the company**

**14.26** The CLR considered whether to retain the traditional understanding that companies should be run for the benefit of shareholders or whether a broader stakeholder approach should be adopted. By way of a limited compromise it proposed that directors should promote ‘enlightened shareholder value’ (see *Developing the Framework*, paras 2.19–2.22; and *Completing the Structure*, para 3.5). According to this approach, directors, while ultimately required to promote shareholder interests, must take account of a range of factors affecting the company’s relationships and performance: ‘the objective is to be achieved by the directors successfully managing the complex of relationships and resources which comprise the company’s undertaking’ (*Developing the Framework*, para 3.51). The CLR therefore recommended that the duty should be so formulated as to remind directors that shareholder value depends on successful management of the company’s relationships with other stakeholders. Section 172(1), which generated considerable debate in the House of Lords, is designed to reflect this objective. It provides that ‘a director must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole . . . .’ The provision therefore aligns the interests of the company (as a metaphysical entity) and its members ‘as a whole’ (see para **14.9**).

The scope of the provision was explained by Lord Goldsmith in the Lords Grand Committee:

*it is for the directors, by reference to those things we are talking about—the objective of*

*the company—to judge and form a good faith judgment about what is to be regarded as success for the members as a whole . . . the duty is to promote the success for the benefit of the members as a whole—that is, for the members as a collective body—not only to benefit the majority shareholders, or any particular shareholder or section of shareholders, still less the interests of directors who might happen to be shareholders themselves (6 February 2006 (column 256)).*

**14.27** Looking to the case law upon which s 172 rests, it was long settled that the pivotal duty of a director is to act honestly and in good faith in the best interests of the company and are thus precluded from exercising their powers to further their own interests or the interests of some third party (i.e. it encapsulates the over-riding duty of loyalty directors owe to the company). The classic formulation, upon which s 172(1) is based, was made by Lord Greene MR in *Re Smith & Fawcett Ltd* (1942) who said that directors ‘must exercise their discretion *bona fide* in what they consider—not what a court may consider—is in the interests of the company’. As is apparent from this statement, and its statutory manifestation, the court will not substitute its own view about which course of action the directors should have taken in place of the board’s own judgement—to this extent the duty is subjective. In *Regentcrest plc v Cohen* (2001), Jonathan Parker J explained that:

*The question is not whether, viewed objectively by the court, the particular act or omission which is challenged was in fact in the interests of the company; still less is the question whether the court, had it been in the position of the director at the relevant time, might have acted differently. Rather, the question is whether the director honestly believed that his act or omission was in the interests of the company. The issue is as to the director’s state mind.*

(See also *Extrasure Travel Insurances Ltd v Scattergood* (2002), discussed later; and *LNOG Ltd v Watford AFC Ltd* (2013)).

**14.28** However, objective considerations are hard to avoid in determining compliance. Accordingly, the determination of whether a director has complied with the s 172 duty appears to involve a

combined subjective-objective test. The objective element was formulated by Pennycuik J in *Charterbridge Corpn Ltd v Lloyd's Bank Ltd* (1970), where the judge stated that the test for determining whether this duty has been discharged 'must be whether an intelligent and honest man in the position of a director of the company concerned, could, in the whole of the existing circumstances, have reasonably believed that the transactions were for the benefit of the company'. Thus, if a director embarks on a course of action without considering the interests of the company and there is no basis on which he or she could reasonably have come to the conclusion that it was in the interests of the company, the director will be in breach (see *Bell Group Ltd (in liq) v Westpac Banking Corporation (No 9)* (2008), in which court applied a dual-limbed subjective/objective test; see also, *Madoff Securities International Ltd (in liq) v Raven* (2013)). In *Re Southern Counties Fresh Food Ltd* (2009), Warren J said that 'it is accepted that a breach will have occurred if it is established that the relevant exercise of power is one which could not be considered by any reasonable director to be in the interests of the company.'

Further, in *Item Software (UK) Ltd v Fassihi* (2004) the Court of Appeal found that directors are under a fiduciary duty to disclose a breach of duty, and this duty is a facet of the core duty of loyalty. Fassihi was employed as the sales and marketing director of the claimants. He set out to disrupt the claimants' renegotiation of their distribution agreement for software products with Isograph Ltd. He first unsuccessfully attempted to procure the contract for RAMS International Ltd, a company he established for that purpose. Thereafter, he persuaded the claimants to adopt a tough bargaining stance with Isograph. Notwithstanding these breaches of fiduciary duty, Item could not establish any resultant loss. The negotiations with Isograph failed because the claimants had pressed them too hard, not because of Fassihi's influence and Isograph did not contract with RAMS. It was therefore critical to identify a further basis of liability to which Item's loss of the contract might be attributed. At first instance, the trial judge held that Fassihi was owed a 'superadded' duty (both as employee and director) to disclose his misconduct. Had he done so, this would have caused the claimant to accept Isograph's proposed terms. It therefore followed that the claimant was entitled to recover for the particular losses flowing from Isograph's

termination. On appeal, the existence in law of a duty to disclose misconduct came to the fore. Arden LJ, rejecting the argument that such a separate and independent duty exists, took the view that the disclosure duty is intrinsic to the overarching duty of loyalty and, therefore, Fassihi was in breach of his duty of loyalty by failing to tell Item that he had set up RAMS and planned to acquire the contract for himself. In *Haysport Properties Ltd v Ackerman* (2016), – [2016] EWHC 393 (Ch) – Peter Smith J therefore took the view that it is now well established that a director has a continuing duty until he ceases to be a director to disclose his own wrongdoing so that, on the facts, there was no limitation issue arising in relation to his breaches of duty. In *GHLM Trading Ltd v Maroo* (2012), Newey J, considering the directors’ duty of good faith, explained that its scope could extend to disclosing any information of interest to the company:

*it can be incumbent on a fiduciary to disclose matters other than wrongdoing. The ‘single and overriding touchstone’ [citing Etherton J in Sheperds Investments Ltd v Walters (2006)] being the duty of a director to act in what he considers in good faith to be in the best interests of the company . . . there is no reason to restrict the disclosure that can be necessary to misconduct. Were a director subjectively to consider that it was in the company’s interests for something other than misconduct to be disclosed, he would, it appears, commit a breach of his duty of good faith if he failed to do so.*

The judge also considered whether a director is under a duty to disclose his misconduct to shareholders. He took the view that if a director subjectively concluded that it was in the company’s interest for a matter to be disclosed to a person who is not a director then he must make such disclosure (see also, *Odyssey Entertainment Ltd v Kamp* (2012)).

**14.29** The overarching nature of the s 172 duty is illustrated by the decision of the Supreme Court of Canada in *Sun Trust Co v Bégín* (1937). The Court stated that self-dealing on the part of directors and giving preference to one shareholder group over and above the shareholders as a whole are types of motivation which could lead a court to conclude that the directors had not acted in good faith for the benefit of the company. An obvious example of a breach of this duty is afforded by *Neptune (Vehicle Washing Equipment) Ltd v Fitzgerald (No 2)* (1995). At a board meeting

attended only by the defendant, the company's sole director, and the company's secretary, it was resolved that his service contract should be terminated and that £100,892 be paid to him as compensation. It was held that the defendant was not acting in what he honestly and genuinely considered to be the best interests of the company but rather was acting exclusively to further his own personal interests (see also *JJ Harrison (Properties) Ltd v Harrison* (2002), discussed later). Similarly, a director who borrows money ostensibly for the benefit of company A but then transfers it to benefit company B which was insolvent and in which he held a substantial shareholding is not acting bona fide in the interests of company A (*Knight v Frost* (1998)). Further, a director exploiting the goodwill of the company's business for his own benefit by registering a trade mark linked to the company's business in his own name is in 'clear breach of his fiduciary duty' (*Ball v Eden Project Ltd* (2002), Laddie J).

**14.30** Provided directors act in good faith and in the interests of the company and are not wilfully blind to the company's interests they will not be liable for breach of fiduciary duty if they make a mistake and act unreasonably, but may be liable for breach of their duty of care (*Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd* (2003), per Leslie Kosmin QC, sitting as a deputy judge in the High Court).

**14.31** A further issue that arises in the context of this duty, and one that serves to show how directors may find themselves placed in an invidious position, concerns groups of companies. Here the question is, in whose interests should the directors act? It will be recalled that in *Extrasure Travel Insurances Ltd v Scattergood* (2002), the directors of Extrasure had transferred company funds, some £200,000, to another company in the group, Citygate Insurance Brokers Ltd (the parent company), to enable it to pay a creditor who had been pressing for payment. It was held that the directors had acted without any honest belief that the transfer was in the interests of the transferor company. The decision serves to illustrate that where a company is one of a number in a group structure, the directors must act bona fide in the interests of that company. This is, after all, a straightforward application of the decision in *Salomon* (see Chapter 2). There may be situations, however, where acting in the interests of the group furthers the interests of the

particular company. For example, if a subsidiary company is owed money by its parent company which is in financial difficulty, the failure on the part of the directors to take action to recover its debts may be in the interests of the subsidiary if, on balance, it would be adversely affected by the liquidation of the parent company (see *Nicholas v Soundcraft Electronics Ltd* (1993), considered in Chapter 11). It is noteworthy that in *Extrasure* the judge emphasised that mere incompetence will not constitute a breach of fiduciary duty provided the director honestly believed he was acting in the best interests of the company. As commented earlier, on the facts, however, the payment of a debt owed by the parent company was not in the best interests of the subsidiary company. The directors were therefore ordered to pay equitable compensation.

### ***Enlightened shareholder value***

**14.32** The CLR's objective that the statutory formulation of the good faith duty (which it termed the 'duty of loyalty') should promote 'enlightened shareholder value' resonates with the approach taken by the Supreme Court of Canada in *People's Department Stores v Wise* (2004), in which the Court stated that acting in the 'best interests of the company required directors to maximise the value of the corporation. This did not mean acting solely in the interests of the shareholders or in any one stakeholder's interest. Rather, as Major and Deschamps JJ explained:

*We accept as an accurate statement of law that in determining whether they are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, inter alia, the interests of the shareholders, employees, suppliers, creditors, consumers, governments and the environment . . . At all times, directors and officers owe their fiduciary duties to the corporation. The interests of the corporation are not to be confused.*

**14.33** Section 172(1) goes on to give content to the notion of enlightened shareholder value by listing a range of factors which, in the discharge of this duty, directors are to have regard (amongst other matters) to:

- (a) the likely consequences of any decision in the long term,
- (b) the interests of the company's employees,

- (c) the need to foster the company's business relationships with suppliers, customers, and others,
- (d) the impact of the company's operations on the community and the environment,
- (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
- (f) the need to act fairly as between members of the company.

The phrase 'have regard to' was explained by Margaret Hodge, then Minister of State for Industry and the Regions:

*The words 'have regard to' means 'think about'; they are absolutely not about just ticking boxes. If 'thinking about' leads to the conclusion, as we believe it will in many cases, that the proper course is to act positively to achieve the objects in the [provision], that will be what the director's duty is. In other words 'have regard to' means 'give proper consideration to' . . . . (Hansard, HC, vol 450, col 789 (17 October 2006)).*

The list of factors set out in s 172 is not exhaustive but is indicative of the importance that the CLR paid to the wider expectations of responsible business behaviour (see the White Paper, 2005, para 3.3). The framing of s 172(1) is intended to place beyond doubt that the need to have regard to the specified factors is subject to the overriding duty to act in the way the director considers, in good faith, would be most likely to promote the success of the company (after all, the duties are owed directly to the company (s 170)). However, in discharging this duty and, more particularly, in taking account of the factors, directors are bound to exercise reasonable care, skill, and diligence (see s 174, discussed later). If challenged on this ground, a director will, therefore, need to demonstrate that the interests listed informed his or her deliberations. This may well lead to changes in the way directors document their decisions and more elaborate 'paper trails'. In this regard, it is noteworthy that the requirement for a strategic report introduced by the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 (SI 2013/1970) (though not applying to small companies and is qualified with respect to medium-sized companies) specifies that its purpose 'is to inform members of the company and help them assess how the directors

have performed their duty under section 172 . . .’ (CA 2006, s 414C(1)).

**14.34** As noted earlier, this provision attracted significant debate while the Companies Bill was going through Parliament and was the cause of considerable anxiety amongst interested parties. For example, the Law Society thought that s 172 might open the commercial decision-making of directors to judicial challenge (see, the Law Society’s ‘Proposed Amendments and Briefing for Parts 10 & 11’ (issued 23 January 2006)). To allay the fear that directors would be exposed to increased litigation and to aid understanding of the statutory statement of directors’ duties, DBERR (now BIS) published a compilation of Ministerial statements on the meaning of the relevant provisions (June 2007). In the Minister of State’s introduction to the document she placed particular emphasis on s 172 explaining that it ‘captures a cultural change in the way in which companies conduct their business’. Accordingly, she stated that there was a time when business success in the interests of shareholders was thought to be in conflict with society’s aspirations for people who work in the company or supply chain companies, for the long-term well-being of the community and the environment: ‘Pursuing the interests of shareholders and embracing wider responsibilities are complementary purposes, not contradictory ones.’ The position taken is that businesses ‘perform better’ when they have regard to a wider group of issues in pursuing success and it concludes by noting that it makes ‘good business sense’ to have regard to the various factors listed in the provision and thereby embrace ‘wider social responsibilities’. Given the anxiety which surrounded the scope of the provision, it is noteworthy that in *Re Southern Counties Fresh Foods Ltd* (2008), the court took the opportunity to compare the statutory formulation of the duty with Lord Greene MR’s statement of the duty in *Re Smith & Fawcett Ltd* and concluded that they amounted to the same thing, although the court acknowledged that the statutory provision gave a more readily understood definition of the scope of the duty. Indeed, proof that s 172 will not lead to an opening of the floodgates of litigation against directors is evident from the short shrift given by Mr Justice Sales to the claimant in *R (on the application of People & Planet) v HM Treasury* (2009). The case arose by way of an application for permission to bring judicial review proceedings. People & Planet objected to HM Treasury’s policy in relation to the management of

the Royal Bank of Scotland (RBS) by UK Financial Investments Ltd (UKFI), the company through which the Government owns RBS. The claimant argued that HM Treasury acted unlawfully in adopting the policy it promulgated relating to how UKFI should manage the investment in RBS. The policy it adopted calls for a commercial approach on the part of UKFI. The claimant objected to this on the basis that UKFI should be promoting a more interventionist approach as a major shareholder in RBS, and seek to persuade or require RBS to change its current commercial lending practices and adopt instead lending policies which did not support ventures or businesses which might be said to be harmful to the environment by reason of their carbon emissions or be said to be insufficiently respectful of human rights. One of the lines of attack made by the claimant was that there was a misdirection of law by HM Treasury as to the effect of s 172. The application was refused. The judge held that in evaluating the policy with reference to the Green Book (which set out guidance for decision-making in central government), officials correctly identified the proper way in which social and environmental considerations may be taken into account by the directors of RBS in the context of the duties of those directors under s 172. He noted that the question then was whether HM Treasury should have sought to go further, so as in effect to seek to impose its own policy in relation to combating climate change and promoting human rights on the board of RBS, contrary to the judgment of the directors:

*In my view, that clearly would have a tendency to come into conflict with, and hence would cut across, the duties of the RBS Board as set out in section 172(1). It would also have given rise to a real risk of litigation by minority shareholders seeking to complain that the value of their shares had been detrimentally affected by the Government seeking to impose its policy on RBS, as was identified in the background document which accompanied the Green Book assessment.*

Mr Justice Sales stressed that decisions regarding the management of RBS will be matters for the judgment of the directors of RBS:

*The policy adopted by HM Treasury is that UKFI can properly seek to influence the Board of RBS to have regard to environmental and human rights considerations in accordance*

*with the RBS Board's duty under s 172 . . . It was a legitimate argument against going further than that that there would be a risk of trying to press the RBS Board beyond the limits of their own duties, and in my view that is all that has been said in paragraph 13(e) of the Green Book assessment, read in its proper context as one reason among others. In my view, on a fair reading of that document, it was not being said that there was an absolute legal bar to the introduction of a different policy, but rather that was a good reason for not pressing the RBS Board by means of a more interventionist policy for UKFI.*

**14.35** Taking account of the interests of employees as required by s 172(1)(b) has long been a statutory requirement. Section 309 of the CA 1985 had provided that 'the matters to which the directors of a company are to have regard in the performance of their functions include the interests of the company's employees in general, as well as the interests of its members'. There were two significant problems with this duty. The first related to its enforceability because it could only be enforced in the same way as any other fiduciary duty owed to a company by its directors (CA 1985, s 309(2)). Either the company had to sue for its breach, or a shareholder had to bring a derivative action (although see *Re Welfab Engineers Ltd* ((1990), considered later). Second, it was difficult to identify the precise scope of the duty for the purposes of determining whether it had been discharged or not. Directors were not bound to give the interests of employees priority over those of shareholders. The CLR therefore reached the conclusion that the provision should be repealed on the basis, as we have seen, that directors should consider employees' interests only as an incident of promoting the company's success for the benefit of its members (*The Strategic Framework* (1999), paras 5.1.20–5.1.23). However, s 247 of the CA 2006 does permit directors to make provision for the benefit of employees and former employees of the company or any of its subsidiaries on the cessation or transfer of the whole or part of the undertaking of the company or the subsidiary. Significantly, s 247(2) states that the power can be exercised even if it will not promote the success of the company in accordance with s 172.

Following recent Government proposals for strengthening stakeholder engagement (see Chs 13 and 16), the Institute of Chartered Secretaries and Administrators (ICSA) and the Investment Association (IA) published guidance notes, 'The Stakeholder Voice in Board Decision Making' (November 2017) aimed at helping boards of directors understand the views of their employees and other stakeholders and how they should take these into account for the purposes of s 172 when making strategic decisions. Ten core principles are listed:

**Comment [A1]:** If a new para number is inserted, subsequent numbers will require correction (and the Table of Cases)

1. directors should identify, and keep under regular review, who they consider their key stakeholders to be and why;
2. directors should determine which stakeholders they need to engage with directly, as opposed to relying solely on information from management;
3. when evaluating their composition and effectiveness, directors should identify what stakeholder expertise is needed in the boardroom and decide whether they have, or would benefit from, directors with directly relevant experience or understanding;
4. when recruiting any director, the nomination committee should take the stakeholder perspective into account when deciding on the recruitment process and the selection criteria;
5. the chair (supported by the company secretary, if applicable) should keep under review the adequacy of the training received by all directors on stakeholder-related matters, and the induction received by new directors, particularly those without previous board experience;
6. the chair (supported by the board, management and the company secretary, if applicable) should determine how best to ensure that the board's decision-making processes give sufficient consideration to key stakeholders;
7. directors should ensure that appropriate engagement with key stakeholders is taking place and that this is kept under regular review;
8. in designing engagement mechanisms, companies should consider what would be most effective and convenient for the stakeholders, not just the company;
9. directors should report to its shareholders on how it has taken the impact on key stakeholders into account when making decisions; and
10. directors should provide feedback to those stakeholders with whom it has engaged, which should be tailored to the different stakeholder groups.

The guidance defines stakeholders as those groups that are likely to be affected by the company's actions, or whose actions can affect the company's operation or business model. Key stakeholders will obviously vary according to a particular company's circumstances, for example its' size, nature of business and location, and so the guidance notes do not provide an exhaustive list. It is intended to update the guidance in June 2018 and it will be reviewed in the second half of 2019 in order to take account of company experience in its application. No doubt it may also need amendment if the Government introduces secondary legislation to strengthen stakeholder engagement (see Ch 13, para 3) and also to reflect the outcomes of the FRC's current consultation on the UK's Corporate Governance Code.

### *Creditors*

**14.36** As a separate constituency creditors do not appear in the list of factors contained in s 172(1), although some of the categories listed such as employees, suppliers, and customers may indeed be creditors. However, s 172(3) provides that 'the duty imposed by this section has effect subject to

any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.’ In this regard, in *Stone & Rolls Ltd v Moore Stephens* (2009), Lord Mance (dissenting) stressed that:

*Section 172(1) of the Companies Act 2006 now states the duty, in terms expressly based on common law rules and equitable principles (see s 170(3)), as being to ‘act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole’—a duty made expressly ‘subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company’ (see s 172(3)).*

The reference to ‘any enactment’ encompasses, for example, the ‘wrongful trading’ provision in s 214 of the Insolvency Act 1986 (see Chapter 17); while the reference to any ‘rule of law’ encompasses the case law in which the courts have recognised that where the company is insolvent, or is of doubtful solvency, the interests of creditors supersedes those of the company’s members so that the focus of the duty switches accordingly. The concern of creditors in this situation lies with ensuring that company assets, to which they will look for payment of their loans, are not dissipated by the directors.

**14.37** There are now significant dicta in a number of English and Antipodean cases in which the judges recognise that directors should have regard to the interests of creditors where the company’s fortunes have declined into insolvency. The position was succinctly stated by Street CJ in *Kinsela v Russell Kinsela Pty Ltd* (1986):

*In a solvent company the proprietary interests of the shareholders entitle them as a general body to be regarded as the company when questions of the duty of directors arise . . . But where a company is insolvent the interests of the creditors intrude. They become prospectively entitled, through the mechanism of liquidation, to displace the power of the shareholders and directors to deal with the company’s assets. It is in a practical sense their assets and not the shareholders’ assets that, through the medium of the company, are under the management of the directors pending either liquidation, return to solvency, or*

*the imposition of some alternative administration.*

This passage was cited with approval by the Court of Appeal in *West Mercia Safety-wear Ltd v Dodd* (1988) which stressed that shareholders do not have the power to absolve directors from a breach of duty to the creditors so as to bar the liquidator's claim. Indeed, in *Winkworth v Edward Baron Development Co Ltd* (1987) Lord Templeman went further by stating that directors owe a duty to the company and to its creditors to ensure that its affairs are properly administered and that its property is not dissipated.

**14.38** The parameters of this duty are still being configured by the courts and the Explanatory Notes to the CA 2006 state that s 172(3) will leave the law to develop in this area. It is clear that in contrast to the duty owed directly to the company during solvency, the duty owed to creditors is indirect because their interests are represented through a liquidator. In *Yukong Line Ltd of Korea v Rendsburg Investment Corpn of Liberia (No 2)* (1998), Toulson J held that a director of an insolvent company who breached his fiduciary duty to the company by transferring assets beyond the reach of its creditors owed no corresponding fiduciary duty to an individual creditor of the company. The creditor could not therefore bring an action against the director for breach of duty. The appropriate cause of action would lie with the liquidator under s 212 of the Insolvency Act 1986 (misfeasance proceedings, see Chapter 17). The issue has come to the fore in two decisions of the Companies Court. In *Re Pantone 485 Ltd* (2002) Richard Reid QC, sitting as a deputy judge in the High Court, observed that:

*In my view, where the company is insolvent, the human equivalent of the company for the purposes of the directors' fiduciary duties is the company's creditors as a whole, i.e. its general creditors. It follows that if the directors act consistently with the interests of the general creditors but inconsistently with the interest of a creditor or section of creditors with special rights in a winding-up, they do not act in breach of duty to the company.*

**14.39** Further, in *Colin Gwyer and Associates Ltd v London Wharf (Limehouse) Ltd* (2003), it was held that a resolution of the board of directors passed without proper consideration being given by certain directors to the interests of creditors would be open to challenge if the company had been

insolvent at the date of the resolution. Leslie Kosmin QC, sitting as a deputy judge in the High Court, stated that:

*In relation to an insolvent company, the directors when considering the company's interests must have regard to the interests of the creditors. If they fail to do so, and therefore ignore the relevant question, the [Charterbridge Corpn Ltd v Lloyd's Bank Ltd (1970)] test can be applied with the modification that in considering the interests of the company the honest and intelligent director must have been capable of believing that the decision was for the benefit of the creditors. In my view the Charterbridge Corporation test is of general application.*

In *Re HLC Environmental Projects Ltd* (2013), the judge reasoned that while the duties under s 172 were usually subjective (see *Re Regentcrest plc v Cohen* (see para 14.27), this is subject to three qualifications in the case of a company of doubtful solvency where an objective assessment becomes more appropriate: (a) in considering whether creditors' interests were 'paramount' (*per* Leslie Kosmin QC in *Colin Gwyer* (see earlier)); (b) where there was no evidence of actual consideration of the best interests of the company, the test is that as set out in *Charterbridge Corporation*; and (c) where a very material interest, such as that of a large creditor, was overlooked (see also, *Hedger v Adams* (2015); *BTI 2014 LLC v Sequana SA* (2016); – [2016] EWHC 1686 (Ch) - and *Ball v Hughes* (2017)). – [2017] EWHC 3228 (Ch) -

**14.40** In summary, it seems that the obligation in s 172(3) is fiduciary in nature; that, as with members, the duty is not owed to any individual creditor but only to the general body of creditors; and that for insolvent companies (or companies of doubtful solvency) the duty to act in the best interests of the company requires the substitution of the word 'creditors' for the word 'company' in s 172(1). Whether or not creditors need this additional protection is questionable given the fraudulent trading and wrongful trading provisions contained in the Insolvency Act 1986 together with s 212 (misfeasance proceedings) of the 1986 Act (considered in Chapter 17; see Finch (1995)).

**14.41** These points aside, while s 172(3) settles the point that directors of insolvent or prospectively insolvent companies owe duties to creditors, the relevant decisions upon which the provision is

based do not lay down any guidance as to when directors should shift their attention away from the company qua body of shareholders towards the interests of its creditors. Clearly this depends upon the company's solvency. But identifying the point in time when a company is insolvent (i.e. when debts cannot be met) is, in practical terms, fraught with difficulty (see the Cork Report, Cmnd 8558 (1982), discussed in Chapter 13).

**(iii) Duty to exercise independent judgement**

**14.42** Section 173(1) provides that a director must exercise independent judgement. This codifies the principle of law whereby directors must not fetter the future exercise of their discretion unless, as laid down in subsection (2), they are acting:

- (a) in accordance with an agreement duly entered into by the company that restricts the future exercise of discretion by its directors, or
- (b) in a way authorised by the company's constitution.

This is an incident of the overarching duty to promote the success of the company laid down in s 172. The duty operates to prevent directors fettering their discretion by, for example, contracting with a third party as to how a particular discretion conferred by the articles will be exercised (*Kregor v Hollins* (1913); see also, *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* (1990)). In *Boulting v Association of Cinematograph, Television and Allied Technicians* (1963), Lord Denning explained the nature of the duty in typically clear terms:

*It seems to me that no one, who has duties of a fiduciary nature to discharge, can be allowed to enter into an engagement by which he binds himself to disregard those duties or to act inconsistently with them. No stipulation is lawful by which he agrees to carry out his duties in accordance with the instructions of another rather than on his own conscientious judgment; or by which he agrees to subordinate the interests of those whom he must protect to the interests of someone else.*

**14.43** But where the board is able to establish that it was in the best interests of the company to enter into such an agreement, the duty will not be broken. For example, the directors may be able to point to some commercial benefit accruing to the company as a result of their undertaking to the

third party. In *Fulham Football Club Ltd v Cabra Estates plc* (1994) four directors of Fulham Football Club agreed with Cabra, the club's landlords, that they would support Cabra's planning application for the future development of the club's grounds rather than the plan put forward by the local authority. In return for this undertaking, Cabra paid the football club a substantial fee. The directors subsequently sought to renege on this promise and argued that it was an unlawful fetter on their powers to act in the best interests of the company. The Court of Appeal, rejecting this argument, stated that:

*It is trite law that directors are under a duty to act bona fide in the interests of their company. However, it does not follow from that proposition that directors can never make a contract by which they bind themselves to the future exercise of their powers in a particular manner, even though the contract taken as a whole is manifestly for the benefit of the company. Such a rule could well prevent companies from entering into contracts which were commercially beneficial to them.*

**14.44** Neil LJ endorsed the view of Kitto J in the Australian case *Thorby v Goldberg* (1964) who had stated that:

*There are many kinds of transaction in which the proper time for the exercise of the directors' discretion is the time of the negotiation of a contract and not the time at which the contract is to be performed . . . If at the former time they are bona fide of opinion that it is in the interests of the company that the transaction should be entered into and carried into effect I see no reason in law why they should not bind themselves.*

Further, the duty prohibits directors delegating their powers unless the company's articles provide otherwise. It has been suggested that s 173 casts doubt on the extent to which a director can rely on other directors (for example, a managing director or a colleague with specialist expertise in relation to a matter requiring a decision of the board) or external consultants (see the Law Society's 'Proposed Amendments and Briefing for Parts 10 and 11 CA 2006' (23 January 2006)). Responding to this anxiety, Lord Goldsmith, in the Lords Grand Committee (6 February 2006 (col 282)), explained that:

*The duty does not prevent a director from relying on the advice or work of others, but the final judgment must be his responsibility. He clearly cannot be expected to do everything himself. Indeed, in certain circumstances directors may be in breach of their duty if they fail to take appropriate advice—for example, legal advice. As with all advice, slavish reliance is not acceptable, and the obtaining of outside advice does not absolve directors from exercising their judgment on the basis of such advice.*

(See further, *Re Westmid Packing Services Ltd* (1998)).

In *Madoff Securities International Ltd v Raven* (2013), Popplewell J explained that in discharging the duty under s 173 it is ‘legitimate for there to be division and delegation of responsibility for particular aspects of the management of a company.’ However, the judge went on to stress that:

*Nevertheless each individual director owes inescapable personal responsibilities. He owes duties to the company to inform himself of the company’s affairs and join with his fellow directors in supervising them. It is therefore a breach of duty for a director to allow himself to be dominated, bamboozled or manipulated by a dominant fellow director . . . .*

(See further, para 14.51.)

#### **(iv) Duty to exercise reasonable care, skill and diligence**

**14.45** Section 174(1) provides that a director of a company must exercise reasonable care, skill and diligence. Section 174(2) goes on to state that this means the care, skill and diligence that would be exercised by a reasonably diligent person with—

<Extract Open>

- (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and*
- (b) the general knowledge, skill and experience that the director has.*

<Extract Close>

The pre-existing case law on the common law duty can be divided into two streams. First, those decisions handed down principally during the 19th century when the courts generally had low expectations of the standard of care to be expected of directors and, second, those cases decided

after the landmark decision in *Donoghue v Stevenson* (1932).

**14.46** To understand the former category, it should be recalled that the early companies frequently appointed a director by virtue of his social standing. They were, therefore, generally symbolic appointments only. For example, in *Re Cardiff Savings Bank, Marquis of Bute's case* (1892), the Marquis had been appointed president of the bank when six months old and had attended only one board meeting in 39 years. It was held that he did not share responsibility for the bank's heavy losses resulting from the irregular conduct of its trustees and managers. Stirling J formulated what has been described as the 'intermittent' theory of directors' duties—namely, that a director must exercise care at the meetings at which he is actually present, but owes no duty to attend any specific meeting, or even any meeting at all.

**14.47** The concern of the courts was to frame the standard of care in terms that were appropriate to company directors who, as commercial risk-takers, should not be held to the same performance standards as trustees. In *Re Forest of Dean Coal Mining Co* (1878), Jessel MR stated that directors are 'commercial men' and that an ordinary director who only attends board meetings periodically 'cannot be expected to devote as much time and attention to the business as the sole managing partner of an ordinary partnership, but they are bound to *use fair and reasonable diligence* in the management of their company's affairs, and to act honestly'. Recourse to objective assessment can therefore be seen in Jessel MR's reasoning; a view which seems to have presaged the approach of Neville J in *Re Brazilian Rubber Plantations and Estates Ltd* (1911) in which the judge laid down a semi-subjective standard of care which was to be determined according to the expertise of the particular director:

*He is not, I think, bound to take any definite part in the conduct of the company's business, but so far as he does undertake it he must use reasonable care in its despatch. Such reasonable care must, I think, be measured by the care an ordinary man might be expected to take in the same circumstances on his own behalf. He is clearly, I think, not responsible for damages occasioned by errors of judgment.*

**14.48** These early decisions were considered by Romer J in *Re City Equitable Fire Insurance Co Ltd*

(1925) in which he attempted to formulate criteria for the assessment of whether the duties of care, skill, and diligence have been discharged. In this case the company's managing director, B, had been convicted of fraud and his fellow directors, who had acted honestly, were alleged to have been negligent in leaving the running of the company in B's hands. Romer J, having reviewed the relevant authorities, said:

*In discharging the duties of his position thus ascertained a director must, of course, act honestly; but he must also exercise some degree of both skill and diligence. To the question of what is the particular degree of skill and diligence required of him, the authorities do not, I think, give any very clear answer. It has been laid down that so long as a director acts honestly he cannot be made responsible in damages unless guilty of gross or culpable negligence in a business sense.*

To this broad statement Romer J added three guiding principles for the determination of the director's duty of care. First, '[a] director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience'. He noted that a director of a life insurance company, for example, does not guarantee that he has the skill of an actuary or of a physician. Second, Romer J stated that a director 'is not bound to give continuous attention to the affairs of his company'. He added that a director's duties are of an 'intermittent nature to be performed at periodical board meetings' and at committees of the board although he 'is not, however, bound to attend all such meetings, though he ought to attend whenever, in the circumstances, he is reasonably able to do so'. Finally, Romer J stated the position with respect to delegation by a director of certain duties: '[I]n respect of all duties that, having regard to the exigencies of business, and the articles of association, may properly be left to some other official, a director is, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly.'

**14.49** Romer J's judgment was delivered some seven years before the landmark decision in *Donoghue v Stevenson* in which the House of Lords triggered the existence of a general duty of care based upon reasonable foresight. Since 1932 the reach of the law of negligence has ebbed and flowed but

it seems certain that directors ‘will not be somehow ring-fenced from its reach so that they are deemed to owe different—and, history would suggest—lower duties of care than non-fiduciaries’ (Worthington (1997); cf Finch (1992)). Since the decision in *Re City Equitable* the law has of course continued to evolve, a process which gained considerable momentum from the corporate governance debate (see Chapters 15 and 16), and, as re-stated by s 174, has reached the stage of holding directors accountable along the lines of traditional negligence principles. For example, in *Daniels v Anderson* (1995) the New South Wales Court of Appeal held that directors owe a common law duty to take reasonable care. Clarke and Sheller JJA stated that: ‘The law of negligence can accommodate different degrees of duty owed by people with different skills but that does not mean that a director can safely proceed on the basis that ignorance and a failure to inquire are a protection against liability for negligence.’

**14.50** Unlike actions for breaches of fiduciary duties, there is a paucity of case law in which directors have been challenged for negligent management (although such allegations are frequently made in cases involving the unfair prejudice remedy, see Chapter 11; now, of course, a derivative claim can be brought against directors for negligence following the reforms introduced by the CA 2006, Part 11, s 260(3), discussed in Chapter 10). However, in two important cases decided by Hoffmann J the standard of care was not measured solely by reference to subjective factors. The approach taken in these decisions clearly informed the drafting of s 174. In *Norman v Theodore Goddard* (1991) Hoffmann J accepted counsel’s submission that the appropriate test was accurately stated in s 214(4) of the Insolvency Act 1986, which defines negligent conduct for the purposes of ‘wrongful trading’:

*the facts which a director of a company ought to know or ascertain, the conclusions which he ought to reach and the steps which he ought to take are those which would be known or ascertained, or reached or taken, by a reasonably diligent person having both: (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company; and (b) the general knowledge, skill and experience that that director has.*

In *Re D'Jan of London Ltd* (1994) Hoffmann LJ, relying on s 214(4) of the 1986 Act, held a director negligent and prima facie liable to the company for losses caused as a result of its insurers repudiating a fire policy for non-disclosure. The director had signed the inaccurate proposal form without first reading it (see later on the issue of relief from liability).

**14.51** The effect of s 174(2), which adopts Lord Hoffmann's position and mirrors the wrongful trading provision, is that a director's actions will be measured against the conduct expected of a reasonably diligent person (see *Gregson v HAE Trustees Ltd* (2008), in which the court confirmed that s 174 codifies the pre-existing law). However, subjective considerations will also apply according to the level of any special skills the particular director may possess. In determining whether the s 174 duty has been breached, McCombe LJ in *Weaving Capital (UK) Ltd v Dabhia* (2013), made the point that provided a trial judge had considered and applied the s 174 standard of care, 'it is not necessary to spell out any further what the duty is or the standard of care to be exercised by the particular [defendant] director . . . .'

There is a synergy between s 174 and cases brought under the Company Directors Disqualification Act 1986 (CDDA) particularly in relation to Romer J's third proposition relating to delegation. Inactivity on the part of directors is not acceptable so that short shrift is given to any contention to the effect that the director was unaware of a state of affairs because he had trusted others to manage the company (*Re Peppermint Park Ltd* (1998); *Re Park House Properties Ltd* (1998); *Re Brian D Pierson (Contractors) Ltd* (2001); *Re Landhurst Leasing plc* (1999); and *Re Finch (UK) plc* (2015)). Or had relied on professional advice as in *ASIC v Healey* (2011), discussed by Lowry (2012); and *Re Bradcrown Ltd* (2001), (discussed at para **13.66**); but note the comments of HH Judge Behrens in *Re Pro4Sport Ltd* (2016): 'relying on professional advice... is an important factor in determining if [the director] was in breach of his duty to exercise reasonable care).- [2015] EWHC 2540 (Ch) - In *Re Barings plc (No 5)* (1999), proceedings were brought under the CDDA for the disqualification of directors of the Barings Bank following the spectacular losses resulting from the unauthorised dealings of a trader, Nick Leeson, who was based in the bank's Singapore office. One of the issues in the case was what

level of supervision should be expected of T, the deputy chairman of the Barings Group, chairman of Barings Investment Bank, and chairman of the Barings Investment Bank Managing Committee. T had argued that in view of the size of the bank's operations his role was basically reactive and that he was justified in trusting delegates until matters came to his attention which required his response. This would appear to accord with Romer J's view of delegation. However, it was held that in determining the period for disqualification, the guiding principle is that directors, collectively and individually, had a duty to acquire and maintain a sufficient knowledge of the company's business so as to enable them to discharge their responsibilities. The power to delegate did not absolve directors from the duty to supervise the way in which delegated functions are carried out. For the duty to be discharged it now seems that proactive monitoring of the operations of delegates must be demonstrated. The courts will not countenance the argument that the director lacked sufficient time to undertake this task.

**14.52** The *Barings* approach can also be seen to have overshadowed the thinking of the Commercial Court in *Equitable Life Assurance Society v Bowley* (2003). It is noteworthy that the action was brought against the insurers' non-executive directors (NEDs). Following the Court of Appeal's decision that the insurer had a real chance of succeeding in negligence against its auditors (see *Equitable Life Assurance Society v Ernst & Young* (2003)), the issue before Langley J was whether the insurer had a real chance of succeeding in negligence against its former NEDs. The background to the case concerned with-profits' policies that provided for guaranteed annuity rates (GARs). After 1995 the GARs exceeded current annuity rates and Equitable's board decided to adopt a differential terminal bonus policy which permitted the insurer to reduce terminal bonuses to GAR policy-holders in order to align their annuities with those payable to non-GAR policy-holders. In 2000 the House of Lords held that the directors had no power under the articles to devalue guaranteed rates and that differential bonus rates were contrary to the terms of the guaranteed annuity policies (see *Equitable Life Assurance Society v Hyman* (2000)). This decision was disastrous for the insurer since it was exposed to liabilities of £1.5bn. In the present case against the NEDs, Equitable was claiming that they were negligent and in breach of

fiduciary duty in failing to take professional advice as to the validity of the differential bonus rates paid out between 1996 and 1998 and, having taken legal advice, in failing to reduce bonuses in 1999 and 2000. Langley J explained that the extent to which a NED could rely on executive directors and other professionals to perform their duties was one in which the law was evolving. However, it was reasonable to expect modern NEDs to be more proactive than traditionally had been the case. The negligence claim had a real prospect of success and it should, therefore, go to trial.

Against the background of the modern case law, the decision in *Lexi Holdings plc (in admin) v Luqman* (2009), is unsurprising. The managing director of Lexi, S, dishonestly misappropriated some £59 million of the company's money via three of its bank accounts. More particularly, S had used a fictitious directors' loan account as a vehicle for perpetrating the fraud. The trial judge found that the inactivity of non-executive directors, M and Z, who were S's sisters, had not caused the loss to the company so that they were not liable to it except in relation to misappropriations he paid to them. The company successfully appealed to the Court of Appeal claiming equitable compensation or damages against M and Z. The Chancellor, delivering the principal judgment of the court, explained that:

*M and Z knew of [S's] convictions. They ought to have known that the directors' loan account as shown in the accounts required convincing explanation. Their duty as directors required them to be on their guard in relation to any explanations from S in response to 'the searching questions' the judge considered that they should have directed to him about the directors' loan account. Had they done their duty S could not have satisfied them that the directors' loan account was genuine.*

It was held that had Z informed the auditors they would not have provided unqualified accounts with the consequence that increased banking facilities would not have been granted and subsequent misappropriations could not have been perpetrated. She was therefore found liable for later misappropriations of nearly £42 million. The misappropriations claimed against M, some £37 million, started three weeks after her appointment and it was held that the loss to that extent was

caused by M failing to discharge her duty as director of Lexi. The passivity of the sisters in failing to act thus constituted a breach of duty and substantial liability ensued.

**(v) Duty to avoid conflicts of interest; duty not to profit personally; and the duty to declare an interest in a proposed or existing transaction or arrangement**

**14.53** Section 175 (duty to avoid conflicts of interest) and ss 177 and 182 (duty to declare an interest in proposed or existing transaction or arrangement) are framed to encompass the equitable obligations which are generally described, respectively, as the ‘no-conflicts’ rule, the ‘no-profits’ rule, and the ‘self-dealing’ rule. These principles can all be classified as incidents of the core fiduciary duty of loyalty (see *Bristol and West Building Society v Mothew* (1996), Millett LJ, later at para **14.55**). Section 175(1) and (2) conflate the equitable principles relating to the ‘no-conflicts’ rule and the ‘no-profits’ rules with the result that the provision encompasses the case law on the corporate opportunity doctrine notwithstanding that the reasoning in much of the relevant jurisprudence is concerned with the no-profits rule (see later). With respect to the duty to avoid self-dealing (i.e. the duty to avoid a personal interest in a transaction to which the company is a party), this has been displaced by a more limited duty to disclose an interest to fellow-directors, ‘to the exclusion of the no-conflicts and no-profits rules’ (see s 175(3) and ss 177 and 182 later).

**(a) The no-conflict and no-profit rules**

**14.54** Section 175(1) provides that a director of a company must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company. The provision replaces the equitable obligation to avoid conflicts of interest whereby directors are liable to account for any profit made personally in circumstances where their interests may conflict with their duty owed to the company. As explained by Deane J in *Chan v Zacharia* (1984), the fiduciary in breach of the no-conflict duty: ‘must account . . . for any benefit or gain which has been obtained or received in circumstances where a conflict or significant possibility of conflict existed between his fiduciary duty and his personal interest in the pursuit or possible receipt of such a benefit or gain’ (see s 178, later). The substance of the rule is strict as is reflected in the language of s 175(1) in that it is framed in terms of the possibility of conflict rather than

actual conflicts of interest. This encompasses the significant body of case law spanning over a century or so which the provision restates (see, for example, *Boardman v Phipps* (1967); in *Sharma v Sharma* (2013), Jackson LJ noted that there is ‘no material difference between the statutory duties under s 175 . . . and the pre-existing fiduciary duties imposed by equity’). However, the provision significantly alters the equitable rules with respect to the authorisation of, and consent or approval to, conflicts of interest (see s 175(4)(b), (5) and (6) and s 180, later).

**14.55** The classic judicial formulation of the no-conflict duty was delivered by Lord Herschell in *Bray v Ford* (1896): ‘It is an inflexible rule of a court of equity that a person in a fiduciary position . . . is not . . . entitled to make a profit; he is not allowed to put himself in a position where his interest and duty conflict.’ A century later, Millett LJ explained in *Bristol and West Building Society v Mothew* (1998), that:

*The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his beneficiary. This core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict.*

Commenting on the scope of the no-conflict rule, Upjohn LJ in *Boulting v Association of Cinematograph, Television and Allied Technicians* (1963) said that it must be applied realistically to a situation which discloses ‘a real conflict of duty and interest’ and not to some ‘theoretical or rhetorical conflict’. Returning to the point again in his dissenting speech in *Boardman v Phipps* (1967), Lord Upjohn stressed that there must be a ‘real sensible possibility of conflict’ between his duty and interest. He concluded:

*In my view it means that the reasonable man looking at the relevant facts and circumstances of the particular case would think that there was a real sensible possibility of conflict; not that you could imagine some situation arising which might, in some conceivable possibility in events not contemplated as real sensible possibilities by any reasonable person, result in a conflict.*

This approach can also be seen in *Chan v Zacharia* (para **14.54**), where Deane J spoke of a

‘significant possibility’ of conflict. Similarly, in *Hospital Products Ltd v United States Surgical Corp* (1984), Mason J thought that ‘a real or substantial possibility of a conflict’ had to be demonstrated (see also, *Queensland Mines Ltd v Hudson* (1978)).

This position is mirrored in s 175(4)(a) which states that the duty is not infringed if ‘the situation cannot reasonably be regarded as likely to give rise to a conflict of interest’ (see, for example, *Peso Silver Mines Ltd v Cropper* (para 14.62)). The provision thus recognises that unexpected situations can arise where a conflict exists but a director will not be in breach until he knows of the conflict and fails ‘to do something about it’ (Official Report, 6/2/2006; coll GC289, Lord Goldsmith).

**14.56** The policy underlying this core fiduciary duty is premised upon the notion of prophylaxis and the approach of the common law in terms of how strict it needed to be cast is an issue that has attracted much academic debate (see, by way of examples, Austin (1987); Lowry (1994); Lowry and Edmunds (1998)). Taken at its absolute level, the case law suggests that liability is triggered without enquiry into the circumstances surrounding the breach of duty and irrespective of whether the company itself suffers loss and so no consideration is given by the courts to whether the errant director was acting in good faith. This absolutist application of fiduciary standards is regarded, at least in the orthodox legal canon, to be the minimum necessary to provide an effective deterrent and ensure the highest degree of loyalty. That said, as we shall see, s 175(4) relaxes the duty in so far that a breach can be authorised by directors.

**14.57** Section 175(2) reflects the equitable rule that it is immaterial whether the company could take advantage of the property, information, or opportunity which has been diverted away from it by the errant director. The leading company law decision is *Regal (Hastings) Ltd v Gulliver* (1942). The company, Regal, owned a cinema in Hastings and its directors wished to acquire two additional local cinemas in order to facilitate the sale of the whole undertaking as a going concern. They therefore formed a subsidiary company in order to take a lease of the other two cinemas. However, the landlord was not prepared to grant the subsidiary a lease on these two cinemas in the absence of a personal guarantee by the directors unless its paid-up capital was £5,000. The

company was unable to inject more than £2,000 in cash for 2,000 shares, and given that the directors did not wish to grant their personal guarantees, the original scheme was changed. It was decided that Regal would subscribe for 2,000 shares and the outstanding 3,000 shares would be taken up by the directors and their associates. Later, the whole undertaking was sold by way of takeover and the directors made a handsome profit. The purchasers of Regal installed a new board of directors and the company brought this action against its former directors claiming that they should account for the profit they had made on the sale of their shares in the subsidiary. The House of Lords found in favour of Regal. Lord Russell of Killowen stated that the opportunity and special knowledge to obtain the shares had come to the directors qua fiduciaries:

*I am of the opinion that the directors standing in a fiduciary relationship to Regal in regard to the exercise of their powers as directors, and having obtained these shares by reason of the fact that they were directors of Regal, and in the course of the execution of that office, are accountable for the profits which they have made out of them.*

This was so despite the fact that the directors had acted bona fide throughout the process, had used their own money, and had not denuded Regal of an opportunity because the company itself was financially incapable of purchasing the shares. Consequently, Regal itself did not suffer any actual loss. Lord Russell enunciated the principle of law thus:

*The rule of equity which insists on those, who by use of a fiduciary position make a profit, being liable to account for that profit, in no way depends on fraud, or absence of bona fides; or upon such questions or considerations as whether profit would or should otherwise have gone to the plaintiff, or whether the profiteer was under a duty to obtain the source of the profit for the plaintiff, or whether he took a risk or acted as he did for the benefit of the plaintiff, or whether the plaintiff has in fact been damaged or benefited by his action. The liability arises from the mere fact of a profit having, in the stated circumstances, been made.*

**14.58** The fact that the company's claim was unjust and that the purchasers had received an 'unexpected windfall' was an issue which was taken up only by Lord Porter, who said that the purchasers of

Regal 'receive[d] in one hand part of the sum which ha[d] been paid by the other'. Having identified the obvious lack of merit in the claim, he nevertheless went on to conclude that 'whether it be so or not, the principle that a person occupying a fiduciary relationship shall not make a profit by reason thereof is of such vital importance that the possible consequence in the present case is in fact as it is in law an immaterial consideration'. Equity's inexorable rule was thus applied without regard to the resulting anomalies.

**14.59** The no-conflict and no-profit rules have in recent times manifested themselves under the guise of the so-called corporate opportunity doctrine—a term which has been imported from North American jurisprudence. Although the doctrine no doubt has its origins in the no-conflict rule it is, however, distinguishable. As will be seen, the Companies Act and the courts will tolerate directors being interested in transactions with the company provided certain disclosure and approval requirements are satisfied. This tolerance does not extend to directors who usurp a corporate opportunity.

#### **Corporate opportunities**

**14.60** Professor Prentice (1974) defines the corporate opportunity doctrine as a principle which 'makes it a breach of fiduciary duty by a director to appropriate for his own benefit an economic opportunity which is considered to belong rightly to the company which he serves'. As is made clear by s 175(2), a corporate opportunity is regarded as an asset belonging to the company which may not therefore be misappropriated by the directors. *Cook v Deeks* (1916) is a paradigm case. The Toronto Construction Co had secured a series of contracts with Canadian Pacific (CP) to build various stretches of railway line. Three of the company's directors, the defendants, decided to sever their links with the fourth director, Cook, and proceeded to incorporate another company, the Dominion Construction Co. The defendants informed CP that their new company would be undertaking the work. The Privy Council held that the defendants held the contract on behalf of the Toronto Construction Co. Lord Buckmaster said that the directors:

*while entrusted with the conduct of the affairs of the company [had] deliberately designed to exclude, and used their influence and position to exclude, the company whose interest it*

*was their first duty to protect . . . men who assume the complete control of a company's business must remember that they are not at liberty to sacrifice the interests which they are bound to protect, and, while ostensibly acting for the company, divert in their own favour business which should properly belong to the company they represent.*

**14.61** The central thrust of equity in relation to corporate opportunities lies in its prophylactic anxiety aimed at preventing directors being unjustly enriched. It is not restricted in scope to only prescribing profits being made at the expense of the company. The prohibition against usurping a corporate opportunity extends to situations where an opportunity is presented to a director personally and not in his capacity as director of the company. In *Industrial Development Consultants Ltd v Cooley* (1972) the defendant, who was managing director of Industrial Development Consultants Ltd (IDC), a design and construction company, failed to obtain for the company a lucrative contract to undertake work for the Eastern Gas Board. The Gas Board subsequently approached Cooley indicating that they wished to deal with him personally and would not, in any case, contract with IDC. Cooley did not disclose the offer to the company, but promptly resigned his office so that he could take up the contract having deceived the company into thinking he was suffering from ill health. Roskill J held that he was accountable to the company for all of the profits he received under the contract. Information which came to Cooley while he was managing director and which was of concern to the claimants and relevant for the claimants to know, was information which it was his duty to pass on to the claimants. It was irrelevant to the issue of liability that Cooley had been approached in his personal capacity and that the Gas Board would not have contracted with IDC. Roskill J concluded that 'if the defendant is not required to account he will have made a large profit as a result of having deliberately put himself into a position in which his duty to the plaintiffs [claimants] who were employing him and his personal interests conflicted'.

**14.62** Compared with the strict approach that characterises English decisions on corporate opportunities, some Commonwealth courts have adopted a less restrictive view towards the issue of liability. In determining whether or not a director has usurped a corporate opportunity, Canadian courts, for

example, will have regard to the fides of the director whose conduct has been challenged. In *Peso Silver Mines v Cropper* (1966) Peso's board was offered the opportunity to buy 126 mining claims, some of which were on land which adjoined the company's own mining territories. The board bona fide declined the offer on the basis of the then financial state of the company, and also because there was some doubt over the value of the claims which therefore rendered them a risky proposition. Subsequently, the company's geologist formed a syndicate with the defendant and two other Peso directors to purchase and work the claims. When the company was taken over, the new board brought an action claiming that the defendant held his shares on constructive trust for the company. The action was unsuccessful and the Supreme Court of Canada dismissed the appeal by the company. It was held that the decision of the Peso directors to reject the opportunity had been made in good faith and for sound commercial reasons in the interests of the company. They could therefore exploit the opportunity themselves. In its reasoning, the Court approved the following statement of Lord Greene, MR, from his judgment in the Court of Appeal in *Regal Hastings*:

*To say that the Company was entitled to claim the benefit of those shares would involve this proposition: Where a Board of Directors considers an investment which is offered to their company and bona fide comes to the conclusion that it is not an investment which their Company ought to make, any Director, after that Resolution is come to and bona fide come to, who chooses to put up the money for that investment himself must be treated as having done it on behalf of the Company, so that the Company can claim any profit that results to him from it. That is a proposition for which no particle of authority was cited; and goes, as it seems to me, far beyond anything that has ever been suggested as to the duty of directors, agents, or persons in a position of that kind.*

**14.63** This approach was again picked up by the Canadian Supreme Court in *Canadian Aero Service Ltd v O'Malley* (1973) ('Canaero') even though the defendant directors in question were held liable. Two directors resigned their posts with Canaero in order to secure a contract in their own right which the company had been actively seeking. It was, in fact, unlikely that the company would

have won the contract in question. Distinguishing the facts before it from those in *Peso*, the Court awarded the company damages based on the profits earned by the two directors. Further, it was held that Canaero did not have to prove that it would have gained the contract or to establish what its profit would have been had it secured the contract. Of particular significance, however, is the approach adopted by Laskin J to the determination of liability. He stated that the Court should give cognisance to all the circumstances surrounding a particular breach including the director's fides:

*The general standards of loyalty, good faith and avoidance of a conflict of duty and self interest . . . must be tested in each case by many factors . . . . Among them are the factor of position or office held, the nature of the corporate opportunity, its ripeness, its specificity and the director's or managerial officer's relation to it, the amount of knowledge possessed, the circumstances in which it was obtained and whether it was special or indeed even private.*

**14.64** Such an open-textured approach to liability contrasts sharply with the orthodox English position which focuses solely upon the capacity of the individual concerned. Yet, together with the *Peso* line of reasoning, Laskin J's approach seems to underlie the Privy Council decision in *Queensland Mines Ltd v Hudson* (1978). Hudson was the managing director of Queensland Mines which had been negotiating with the Tasmanian Government for mining exploration licences. The company decided not to pursue the opportunity due to a lack of capital and the significant risks involved in the development. Hudson thereupon used his own resources to prove the value of the mineral deposits in his own name. Resigning as Queensland's managing director, Hudson formed his own company and sold the licences to an American company for a significant profit. Queensland Mines sought to make Hudson liable to account. The Privy Council held that he was not liable. The company was fully informed that Hudson was seeking this opportunity, having rejected it itself. In reaching its decision, the Privy Council was mindful that Hudson had also incurred significant potential personal liability in the event that the mineral deposits had proved inadequate.

**14.65** Modern English decisions have, however, stressed that the determination of liability for breach of fiduciary duty necessarily requires the court to engage in a fact intensive exercise in examining the

circumstances surrounding a director's alleged breach. For example, in *In Plus Group Ltd v Pyke* (2002), the defendant, Pyke, and Plank were the only two directors and shareholders of the claimant company. A stroke in 1996 resulted in the defendant being unable to work. His absence continued when his working relationship with Plank broke down early in 1997. From that time until the defendant formally resigned, he was effectively excluded from decision making and participation in the management of the claimant company's affairs. In June 1997, during his period of exile, the defendant incorporated his own company, John Pyke Interiors Ltd, through which he procured and discharged a contract worth £200,000 with Constructive Ltd, a customer of *Plus Group Ltd*. It was alleged, therefore, that this was done in breach of duty to the claimant company. The evidence from the correspondence between Constructive Ltd and the claimants suggested that the relationship between the two had deteriorated to such an extent that it was highly unlikely that further contracts would be placed with the claimants. On a pure application of *Cooley* this, in itself, would not absolve Pyke. Yet the Court of Appeal, by differing routes, exonerated him. First, the Court enlisted *Mashonaland Exploration Co Ltd v New Mashonaland Exploration Co Ltd* (1891) (considered later) that has been taken as holding that directors can hold competing directorships. Further, Sedley LJ, while acknowledging that Pyke successfully poached a customer, nevertheless took the view that:

*Quite exceptionally, the defendant's duty to the claimants had been reduced to vanishing point by the acts (explicable and justifiable as they may have been) of his sole fellow director and fellow shareholder Mr Plank . . . . The defendant's role as a director of the claimants was throughout the relevant period entirely nominal, not in the sense [in] which a non-executive director's position might (probably wrongly) be called nominal but in the concrete sense that that he was entirely excluded from all decision-making and all participation in the claimant company's affairs. For all the influence he had, he might as well have resigned.*

In his reasoning, Brooke LJ called in aid the observation of Lord Upjohn in *Phipps v Boardman* (1967), to the effect that the circumstances of 'each case must be carefully examined to see

whether a fiduciary relationship exists in relation to the matter of which complaint is made'. He laid particular emphasis on the fact that following his stroke Pyke had been effectively expelled from the company some six months prior to any of the events in question. Brooke LJ stressed that although the defendant had invested a significant sum of money in the companies of which he was a director and on favourable interest-free terms, he was not permitted to withdraw any of it and he was denied any remuneration. Further, at the time of the contract with Constructive he was not using any of the claimants' property nor was he using any confidential information which came to him qua director of the companies. He therefore concluded that in contracting with Constructive, Mr Pyke was not in breach of fiduciary duty.

**14.66** It is curious that the Court of Appeal did not follow the more principled route of finding the director liable but granting him relief under s 1157 of the CA 2006 (discussed later), or, indeed, holding that the appropriate cause of action was for Pyke to petition for relief under s 994 (see Chapter 11). Exclusion from management is, after all, a paradigm illustration of unfairly prejudicial conduct.

**14.67** Equity's strict prophylactic view of fiduciary liability where a director has misappropriated a corporate opportunity for his own benefit can be seen in the reasoning of Peter Smith J in *Crown Dilmun v Sutton* (2004). The dispute centred on the £50m sale of Fulham Football Club's Craven Cottage ground. As managing director of Crown Dilmun, Sutton's primary role was to identify suitable investment opportunities for the claimant company. Acting in this capacity, he first declined the development proposal of Craven Cottage on behalf of the claimant company. Thereafter, he pursued negotiations for a revised development project through the medium of the second defendant company which Sutton established specifically for this purpose. Peter Smith J dismissed Sutton's evidence of his genuine belief that the company would not have been interested in the development opportunity, finding it to be untrue and dishonest. Echoing the reasoning of Roskill J in *IDC v Cooley* (1972) (discussed earlier), he said:

*Given my decision that Mr Sutton had no right to make any decision to take opportunities which came his way whilst he was a director of the claimants, the parties all agree that he*

*came under a duty not to take opportunities which arose that might put him in conflict with his duties to the claimants. As a director of the claimants, he had a duty to exploit every opportunity that he became aware of for the benefit of the claimants. The only exception is if they permit him to take such opportunities after he has made full and frank disclosure and they have given full and informed consent.*

(See also, *Berryland Books Ltd v BK Books Ltd* (2009); *Don King Productions Inc v Warren* (2000) CA; and *Gencor ACP Ltd v Dalby* (2000).)

**14.68** Similarly, the approach adopted by the Court of Appeal in *Bhullar v Bhullar* (2003), resonates clearly with that seen in the classic decisions on liability for usurping corporate opportunities such as *Regal (Hastings)*, *Cook v Deeks*, and *IDC v Cooley*. Silvercrest (S), a company controlled by the two appellants, acquired a property, White Hall Mill, at a time that they, along with other family members who included the respondents, were directors of Bhullar Bros Ltd (B Ltd). The objects of B Ltd included the acquisition of investment property. It already owned property in the vicinity of White Hall Mill; and in evidence the appellants conceded that its acquisition would have been commercially worthwhile. One of them even sought legal advice on the propriety of Silvercrest entering into the transaction. However, before the purchase, B Ltd's board resolved to divide its business, and refrain from making any further property acquisitions. The appellants therefore resisted B Ltd's claim to White Hall Mill, because, they argued, its purchase was not related to that company's affairs, nor could it be described as a maturing business opportunity available to it. Counsel for B Ltd countered with a submission based upon *IDC v Cooley*:

*that a director may come under a positive duty to make a business opportunity available to his company if it is in the company's line of business or if the director has been given responsibility to seek out particular opportunities or the company and the opportunity concerned is of such a nature as to fall within the scope of that remit.*

As commented above, the approach of the Court of Appeal owes much to the traditional line of authority on fiduciary obligations which also includes *Aberdeen Rly Co v Blaikie Bros* (see earlier) and *Phipps v Boardman* (see earlier). This being so, the Court noted that reasonable men looking at

the facts would have concluded that the appellants faced a real sensible possibility of conflict of interest. The Court's reasoning affirms counsel's preference for a broad, capacity-based approach as articulated by Roskill J in *IDC v Cooley*. It thus seems that any opportunity within the company's line of business is off-limits to the director unless the company's permission to proceed is first obtained. As Jonathan Parker LJ explained:

*Whether the company could or would have taken that opportunity, had it been made aware of it, is not to the point: the existence of the opportunity was information which it was relevant for the company to know, and it follows that the [directors] were under a duty to communicate it to the company.*

(See also *Quarter Master UK Ltd v Pyke* (2005), and the Court of Appeal's approach in *Wrexham Association Football Club Ltd v Crucial Move Ltd* (2006).)

More recently, the approach seen in *Bhullar* towards the liability of directors who benefit from a corporate opportunity notwithstanding the fact that the company itself could not have benefited from it was also taken by the Court of Appeal in *O'Donnell v Shanahan* (2009), where the action against the directors was brought under the unfair prejudice provision (see Chapter 11). Rimer LJ observed that:

*the rationale of the 'no conflict' and 'no profit' rules is to underpin the fiduciary's duty of undivided loyalty to his beneficiary. If an opportunity comes to him in his capacity as a fiduciary, his principal is entitled to know about it. The director cannot be left to make the decision as to whether he is allowed to help himself to its benefit.*

(See also, *Towers v Premier Waste Management Ltd* (2011).)

The judge (with whom Aikens and Waller LJ agreed) laid emphasis on the fact that, as explained by Lord Russell in *Regal (Hastings)*, directors are precluded from making use of information concerning an opportunity for their own benefit when that information is obtained in the course of them acting as directors of the company, and the opportunity presented itself to them by reason of the fact that they were directors of the company.

### Post-resignation breach of duty

**14.69** It will be recalled that s 170(2) provides that a person who ceases to be a director continues to be subject to the duty in s 175 (and s 176, see later). Consequently, resignation does not immunise a director against liability for breach of the no-conflict duty. Looking to the case law, it seems safe to conclude that the statutory formulation of the no-conflict duty does not prevent a director from forming the intention, while still a director, to set up in competition after his directorship has ceased nor does it prevent him from taking *preliminary* steps to investigate or forward that intention provided he did not engage in any actual competitive activity while his directorship continued, provided, of course, any contract of service does not prohibit such activity. Policy considerations underlie the decisions. For example, in *Balston Ltd v Headline Filters Ltd* (1990), Head (H), a director of the plaintiff company, agreed to lease certain commercial premises in order to start up his own business. He then resigned from the company although, unlike Cooley, he had not at that stage decided upon the nature of the business he would enter. However, shortly after his resignation, one of Balston's customers contacted H after being told that the company would be discontinuing its supply to him of a certain type of filter tube. H therefore began manufacturing the filters and supplied them to the customer. Balston sought to hold him liable to account. Falconer J held that it was not a breach of fiduciary duty for a director to start up a business in competition with his former company after his directorship had ceased, even where the intention to commence business was formed prior to the resignation. On the evidence, Head had not attempted to divert to himself a maturing business opportunity, an opportunity which was in the contemplation of Balston Ltd. Falconer J explained that:

*In my judgment an intention by a director of a company to set up business in competition with the company after his directorship has ceased is not to be regarded as a conflicting interest within the context of the principle, having regard to the rules of public policy as to restraint of trade, nor is the taking of any preliminary steps to investigate or forward that intention so long as there is no actual competitive activity, such as, for instance, competitive tendering or actual trading, while he remains a director.*

Similarly, in *Island Export Finance Ltd v Umunna* (1986), Hutchinson J said:

*It would . . . be surprising to find that directors alone, because of the fiduciary nature of their relationship with the company, were restrained from exploiting after they had ceased to be such any opportunity of which they had acquired knowledge while directors. Directors, no less than employees, acquire a general fund of knowledge and expertise in the course of their work, and it is plainly in the public interest that they should be free to exploit it in a new position.*

And again, in *Framlington Group plc v Anderson* (see earlier), Blackburne J reasoned that in the absence of special circumstances, such as a prohibition in a service contract, a director commits no breach of duty merely because, while a director, ‘he take steps so that, on ceasing to be a director . . . he can immediately set up business in competition with that company or join a competitor of it. Nor is he obliged to disclose to that company that he is taking those steps.’

(See also, *Coleman Taymar Ltd v Oakes* (2001); and *LC Services Ltd v Brown* (2003)).

**14.70** Further, a director can utilise confidential information or ‘know-how’ acquired while working for the company after he departs but not ‘trade secrets’ (*Dranez Anstalt v Hayek* (2002), per Evans-Lombe J; *FSS Travel and Leisure Systems Ltd v Johnson* (1998), per Mummery LJ). Typical examples of trade secrets include company databases, customer lists, suppliers’ agreements, and business and sales strategy (see *Item Software (UK) Ltd v Fassihi* (2003); and *Quarter Master UK Ltd v Pyke* (2004)).

A cogent summary of the case law was provided by Etherton J in *Shepherds Investments Ltd v Walters* (2006): - [2006] EWHC 836 (Ch) -

*What the cases show... is that the precise point at which preparations for the establishment of a competing business by a director become unlawful will turn on the actual facts of any particular case. In each case, the touchstone for what, on the one hand, is permissible, and what, on the other hand, is impermissible unless consent is obtained from the company... after full disclosure, is what, in the case of a director, will be in breach of the fiduciary duties to which I have referred... . It is obvious, for example, that merely making a decision to set up a competing business at some point in the future and discussing such an idea with friends and family would not of themselves be in conflict with the best interests of the company... . The consulting of lawyers and other professionals may, depending on all the circumstances, equally be consistent with a director's fiduciary duties... . At the other end of the spectrum, it is plain that soliciting customers of the company... or the actual carrying on of trade by a*

*competing business would be in breach of the duties of the director... . It is the wide range of activity and decision making between the two ends of the spectrum which will be fact sensitive in every case....*

In *Shepherds Investments Ltd* the directors were found to be in breach of duty because they had formed an irrevocable intention to establish a business which they knew would fairly be regarded as a competitor but continued to take steps to bring it into existence contrary to the best interests of the company. At that point, it was held to be incumbent upon them to inform the company of the relevant activity (see also, *Gamatronic (UK) Ltd v Hamilton* (2016)). – [2016] EWHC 2225 (QB) -

**14.71** In *Foster Bryant Surveying Ltd v Bryant* (2007), Rix LJ confirmed the need for a nuanced approach to be taken towards allegations of post-resignation breaches. Drawing on Lawrence Collins J's reasoning in *CMS Dolphin Ltd v Simonet* (2001), he gave prominence to the finding that there must be 'some relevant connection or link between the resignation and the obtaining of the business.' In so doing, he placed emphasis upon the need to demonstrate both lack of good faith with which the future exploitation was planned while still a director, and the need to show that the resignation was an integral part of the dishonest plan. These factors are clearly illustrated by *CMS Dolphin Ltd v Simonet* (2001). C, an advertising company, successfully claimed that S, its former managing director, was in breach of fiduciary duty and duty of fidelity by virtue of his employment contract by diverting a maturing business opportunity to a new company established by him following his resignation from C. It was argued that S had resigned in order to acquire for himself the opportunity sought by C and that he had diverted parts of C's business, and taken its staff with him, to his new company. Lawrence Collins J held that a director's power to resign from office is not a fiduciary power and a director is entitled to resign even if it might have a disastrous effect on the business or reputation of the company and he was not precluded from using his general fund of skill and knowledge to compete with his former company. However, appropriating a maturing business opportunity belonging to C was a misuse of its property for which S was liable.

**14.72** Thus, in cases where liability for post-resignation breach of duty had been found, there was a causal connection between the resignation and the subsequent diversion of the opportunity to the director's new enterprise. On the other hand, in cases such as *Island Export Finance Ltd* (see

earlier) and *Balston* (see earlier), the resignations ‘were unaccompanied by disloyalty’ so that there was no liability. That said, in *Foster Bryant*, Rix LJ recognised the difficulty of accurately summarising the circumstances in which retiring directors may or may not be held to have breached their fiduciary duties given that the issue is ‘fact sensitive’.

(See also, *Hunter Kane Ltd v Watkins* (2002); *Berryland Books Ltd v BK Books Ltd* (2009); and *Thermascan Ltd v Norman* (2011)).

The pragmatic approach taken by the judges in these modern decisions is manifested in s 175(4)(a) which states, in language that mirrors the limits placed on the scope of duty by, for example, Lord Upjohn (see para 14.55), that the no-conflict duty is not infringed if the situation cannot reasonably be regarded as likely to give rise to a conflict of interest. The provision thus acknowledges that cases involving breaches of fiduciary duty by a director are indeed ‘fact-sensitive’. As Moses LJ in *Foster Bryant* concluded, this tends ‘to make one almost nostalgic for the days when there were inflexible rules, inexorably enforced by judges who would have shuddered at the reiteration of the noun-adjective’.

#### **Conflicts of interest and duty and conflicts of duties**

**14.73** Section 175(7) states that ‘any reference in this section to a conflict of interest includes a conflict of interest and duty and a conflict of duties.’ This at last injects a long awaited measure of cohesion in to the law and settles a long running dispute surrounding what was seen to be an anomalous decision of Chitty J in *London and Mashonaland Co Ltd v New Mashonaland Exploration Co Ltd* (1891). The claimant company sought an injunction to prohibit one of its directors, Lord Mayo, from holding such office with the defendant company, a business rival. In April 1891, one month after the claimant company’s registration, its directors resolved to appoint Lord Mayo as director and chairman of the board. In July of the same year, the defendant company issued its prospectus which contained Lord Mayo’s name at the head of its list of directors. The claimant was unable to prove that any confidential information had been disclosed to the defendant company. Chitty J refused the injunction, reasoning that even if Lord Mayo had been duly appointed to the claimant company’s board, its articles did not contain any provision which required him to give ‘any part of

his time . . . to the business of the company, or which prohibited him from acting as a director of another company; neither was there any contract . . . to give his personal services to the plaintiff company and to another company'. This decision was approved by the House of Lords in *Bell v Lever Bros Ltd* (1932).

**14.74** While *Mashonaland* has long been accepted as authority for the proposition that a director is not placed in breach of duty by acting as director for a competing company—double employment nevertheless, on its facts, no actual conflict arose because the defendant company had not commenced business and therefore no damage had been sustained by the claimant. In any case, if *Mashonaland* was authority for permitting double employment, a director of two competing companies would have to walk a fine line to avoid a finding of conflict of duty: '[a]t all times . . . he metaphorically wears both hats and owes duties in both capacities' (*Gwembe Valley Development Co Ltd v Koshy* (1998), Harman J). Further, Millett LJ in *Bristol and West Building Society v Mothew* (1998) placed the 'double employment rule' firmly within the realms of conflicts of interests and in *In Plus Group Ltd v Pyke* (see earlier), Sedley LJ questioned whether *Mashonaland* could still be regarded as good law. Citing, inter alia, Lawrence Collins J's judgment in *CMS Dolphin Ltd v Simonet* (see earlier), he explained that:

*If one bears in mind the high standard of probity which equity demands of fiduciaries, and the reliance which shareholders and creditors are entitled to place upon it, the Mashonaland principle is a very limited one. If, for example, the two Mashonaland Exploration companies had been preparing to tender for the same contract, I doubt whether Lord Mayo's position would have been tenable, at least in the absence of special arrangements to insulate either company from the conflict of his interests and duties, for I see no reason why the law should assume that any directorship is merely cosmetic. A directorship brings with it not only voting rights and emoluments but responsibilities of stewardship and honesty, and those who cannot discharge them should not become or remain directors . . . [T]he fiduciary must not only not place himself in a position [of conflict of interest]; if, even accidentally, he finds himself in such a position he must*

*regularise or abandon it . . . [It is not the case that] a director can cheerfully go to the brink so long as he does not fall over the edge. It means that if he finds himself in a position of conflict he must resolve it openly or extract himself from it.*

In this regard, the remarks of Lord Denning in *Scottish Co-operative Wholesale Society Ltd v Meyer* (1959), a case decided under the old oppression remedy (see Chapter 11), are particularly pertinent. Three directors of a holding company, SCWS, were appointed to the board of its subsidiary, a textile company. Lord Denning observed that:

*So long as the interests of all concerned were in harmony, there was no -difficulty . . . But, so soon as the interests of the two companies were in conflict, the nominee directors were placed in an impossible position . . . They put their duty to the co-operative society above their duty to the textile company . . . By subordinating the interests of the textile company to those of the co-operative society, they conducted the affairs of the textile company in a manner oppressive to the other shareholders.*

Section 175(7) therefore gives statutory effect to the views expressed by Millett LJ (in *Bristol and West Building Society v Mothewe*) and Sedley LJ (in *In Plus Group Ltd v Pyke*) so that such appointments will need to be authorised in accordance with s 175(5) (see later).

#### **Avoiding liability for conflicts of duty: authorisation by the directors**

**14.75** A major concern expressed by the Company Law Review was that the case law on conflicts of duty holds the potential to ‘fetter entrepreneurial and business start-up activity by existing directors’ and that ‘the statutory statement of duties should only prevent the exploitation of business opportunities where there is a clear case for doing so’ (*Completing the Structure*). The 2005 White Paper echoes this concern by stating that it is important that the duties do not impose impractical and onerous requirements which stifle entrepreneurial activity (at para 3.26). Section 175(5)(a) therefore implements the CLRSG’s recommendation that conflicts may be authorised by independent directors unless, in the case of a private company, its constitution otherwise provides. For a public company the directors will only be able to authorise such conflicts if its constitution expressly permits (s 175(5)(b)). Further, s 175(6) provides that board authorisation is effective

only if the conflicted directors have not participated in the taking of the decision or if the decision would have been valid even without the participation of the conflicted directors; the votes of the conflicted directors in favour of the decision will be ignored and the conflicted directors are not counted in the quorum. If all the directors are or may be conflicted, only shareholder approval will suffice (see para **14.92**).

**(b) Self-dealing directors**

**14.76** The underlying rationale of the self-dealing rule which prohibits a director from being interested in a transaction to which the company was a party was explained by the House of Lords in *Aberdeen Rly Co v Blaikie Bros* (1854). The company had contracted with John Blaikie for the supply of iron chairs. At the time of the contract John Blaikie was both a director of Aberdeen Railway and a partner of Blaikie Bros. Lord Cranworth LC, having stated that ‘no-one, having [fiduciary] duties to discharge, shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting, or which possibly may conflict, with the interests of those whom he is bound to protect’, went on to stress that:

*his duty to the company imposed on him the obligation of obtaining these iron chairs at the lowest possible price. His personal interest would lead him in an entirely opposite direction, would induce him to fix the price as high as possible. This is the very evil against which the rule in question is directed.*

In a similar vein Megarry VC observed in *Tito v Waddell (No 2)* (1977):

*The self-dealing rule is (to put it very shortly) that if a trustee sells the trust property to himself, the sale is voidable by any beneficiary ex debito justitiae, however fair the transaction . . . . [E]quity is astute to prevent a trustee from abusing his position or profiting from his trust: the shepherd must not become a wolf.*

(See also, the joint judgment of Rich, Dixon, and Evatt JJ in *Furs Ltd v Tomkies* (1936).)

**14.77** The statutory statement of directors’ duties does not follow the common law position in this regard and, indeed, substantially modifies it insofar as self-dealing is removed from the realms of directors’ fiduciary duties and replaced with a statutory obligation to disclose an interest. Section 175(3)

makes it clear that the duty to avoid conflicts of interest contained in s 175(1) ‘does not apply to a conflict of interest arising in relation to a transaction or arrangement with the company’. Rather, ‘self-dealing’ falls within s 177(1) which provides that: ‘[i]f a director is in any way, directly or indirectly, interested in a proposed transaction or arrangement with the company, he must declare the nature and extent of that interest to the other directors.’ In similar terms s 182 applies to cases where a director has an interest in a transaction after it ‘has been entered into by the company’. The provisions do not apply to substantial property transactions, loans, quasi-loans and credit transactions which require the approval of the company’s members (see ss 190–203, later).

**14.78** Sections 177 and 182 reflect the common practice that companies (see, for example, art 85 of the 1985 Table A and s 317 CA 1985) generally permitted directors to have interests in conflict transactions, provided they were declared to the board. The reason why the common law tolerated such relaxation of the rule was explained by Upjohn LJ in *Boulting v Association of Cinematograph Television and Allied Technicians* (1963):

*It is frequently very much better in the interests of the company . . . that they should be advised by someone on some transaction, although he may be interested on the other side of the fence. Directors . . . may sometimes be placed in such a position that though their interest and duty conflict, they can properly and honestly give their services to both sides and serve two masters to the great advantage of both. If the person entitled to the benefit of the rule is content with that position and understands what are his rights in the matter, there is no reason why he should not relax the rule, and it may commercially be very much to his advantage to do so.*

**14.79** The principal distinction between the two statutory provisions is that whereas breach of s 177 carries civil consequences (s 178), breach of s 182 results in criminal sanctions (s 183). More particularly, s 178 states that the consequences of breach (or threatened breach) of ss 171–177 are the same as would apply if the corresponding common law rule or equitable principle applied. This is subject to the proviso introduced by s 180(1) that, subject to any provision to the contrary in the company’s constitution, if s 177 is complied with, the transaction is not liable to be set aside

by virtue of any common law rule or equitable principle requiring the consent of members. We explore this provision further later, but for present purposes it is noteworthy that under s 317 of the CA 1985, the predecessor to both ss 177 and 182, it was settled that a director's breach of the statutory duty of disclosure triggers only the criminal sanctions provided for, and not any civil consequences *per se*. The contract itself is valid until avoided by the company (*Guinness plc v Saunders* (1990); *Hely-Hutchinson v Brayhead Ltd* (1968)). As a condition of rescission of a voidable contract there must be *restitutio in integrum*: 'the parties must be put in *status quo*; for this purpose a court of equity can do what is practically just, even though it cannot restore the parties precisely to the state they were in before the contract' (*Guinness plc v Saunders*, Lord Goff). In *Craven Textile Engineers Ltd v Batley Football Club Ltd* (2000) the issue was whether H, a former director of the defendant football club, could claim payment of unpaid invoices for goods and work and materials supplied to the club, even though he had failed to disclose his interest as a director and principal shareholder of the claimant company, Craven. The Court of Appeal held that notwithstanding H's failure to disclose his interest in the contracts, the football club should pay the outstanding invoices. Clarke LJ, citing Lord Goff's statement of principle in *Guinness plc v Saunders*, said that '[i]t is important to note that the court does not have a general discretion to do what seems fair and just in all the circumstances. The court will only treat the company as entitled to avoid the contract if it can do what is practically just to restore the parties to the position which existed before'. Finally, commenting on the consequences which flow from a breach of the statutory duty of disclosure, the judge in *Coleman Taymar* (earlier) observed that it does not give the company a separate right of action for damages against the director: '[a]ny right of action arises from the breach of fiduciary duty and not from the section [317 CA 1985].' Now that the self-dealing rule is outwith the no-conflicts rule, it would seem that the civil consequences for failing to declare an interest under s 177 are extremely limited.

**14.80** An issue which came before the courts under s 317 CA 1985 was whether it required disclosure at a formal board meeting in cases where all the directors of a company have informal notice of the conflict-transaction. It was held at first instance in *Guinness plc v Saunders* (1990) that

compliance with s 317 requires disclosure to a duly convened and constituted board meeting, a function which cannot be delegated to a sub-committee of the board. The issue was not directly addressed in the House of Lords' decision. Fox LJ in the Court of Appeal opined that even if all the members of the board had known of a contract this would not validate payments made thereunder. Whether or not a director should make formal disclosure of interests which are patently obvious, such as his interest in his own service contract which is generally known to all boardroom colleagues, has been a matter on which the judges have differed. In two 1990s cases it was said that in such circumstances formal disclosure is not required (*Lee Panavision Ltd v Lee Lighting Ltd* (1992); *Runciman v Walter Runciman plc* (1992)). On the other hand, in *Neptune (Vehicle Washing Equipment) Ltd v Fitzgerald* (1995), Lightman J held that strict compliance with the statutory disclosure requirement was necessary even in the case of companies with a sole director. Such a director should make the declaration to himself and record the declaration in the minutes. This was reluctantly applied by the court in *Neptune (Vehicle Washing Equipment) Ltd v Fitzgerald (No 2)* (1995), although the court expressed the view that a better solution would be to require disclosure by a sole director to the members in general meeting. This is a somewhat curious conclusion given the nature of such companies where generally a sole director will also control the majority of the shares. The most recent judicial pronouncement departs from Lightman J's formalistic approach. In *MacPherson v European Strategic Bureau Ltd* (1999) Ferris J emphatically supported the line of reasoning adopted by the court in *Runciman*. On the facts of *MacPherson*, each of the shareholders and the directors knew the precise nature of others' interest so that there was in effect unanimous approval of the agreement. Ferris J thus concluded that '[n]o amount of formal disclosure by each other to the other would have increased the other's relevant knowledge'. But it should be noted that a board's knowledge in general terms that a colleague has engaged in a conflict-transaction will not amount to sufficient disclosure. The board has to be given full and precise information (*Gwembe Valley Development Co Ltd v Koshy* (1999), Harman J; see also the comments of Neuberger J on the disclosure standard in *EIC Services Ltd v Phipps* (earlier)).

**14.81** Section 177(6)(b) and s 182(6)(b) seek to solve this problem by providing that a director need not declare an interest ‘if, or to the extent that, the other directors are already aware of it (and for this purpose the other directors are treated as aware of anything of which they ought reasonably to be aware). As the duty requires disclosure to be made ‘to the other directors’, no disclosure is required where the company has only one director.

It should be noted that the 2008 model articles prohibit a director who has an interest in an actual or proposed transaction or arrangement with the company from participating in the decision-making process for quorum or voting purposes (art 14(1) for private companies limited by shares; arts 13(3) and 16(1) for public companies). It is expressly provided that the prohibition does not apply if the director’s interest cannot reasonably be regarded as likely to give rise to a conflict of interest (see also, ss 177(6)(a) and 182(6)(a)). The 2008 model articles also provide for members, by ordinary resolution, disapplying the prohibition on voting.

**(vi) Duty not to accept benefits from third parties**

**14.82** Section 176(1) provides that a director must not accept a benefit from a third party conferred by reason of (a) his being a director, or (b) his doing (or not doing) anything as director. This duty is an element of the wider no-conflict duty laid down in s 175 and it too will not be infringed if acceptance of the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest. As Lord Goldsmith explained in the Lords Grand Committee (Official Report, 9 February 2006; (col 330)), the provision codifies the ‘long-standing rule, prohibiting the exploitation of the position of director for personal benefit.’

It should be noted that the duty applies only to benefits conferred because the director is a director of the company or because of something that the director does or does not do as director. The word ‘benefit’, for the purpose of this section, is not defined by the statute although during the Parliamentary debates on the Bill it was made clear that it includes benefits of any description, including non-financial benefits (Official Report, 9 February 2006; coll GC330 (Lord Goldsmith). Guidance on bribes was given by Andrew Smith J in *Fiona Trust & Holding Corp v Privalov* (2010): – [2010] EWHC 3199 (Comm)

*English law takes a broad view of what constitutes a bribe for the purposes of civil claims. It considers that a bribe (or 'secret commission' or 'surreptitious payment') has been paid where '(i) ... the person making the payment makes it to the agent of another person with whom he is dealing; (ii) ... he makes it to that person knowing that that person is acting as the agent of the other person with whom he is dealing; and (iii) ... he fails to disclose to the other person with whom he is dealing that he has made that payment to the person he knows to be the other person's agent: Industries & General Mortgage Co Ltd v Lewis (1949) – [1949] 2 All ER 573*

While s 175(5) provides for board authorisation in respect of conflicts of interest, this is not the case with this particular duty. However, the company may authorise the acceptance of benefits by virtue of s 180(4) (see later). Section 176(2) defines a 'third party' as a person other than the company or its holding company or its subsidiaries and thus s 176(3) provides that benefits provided by the company fall outside the prohibition.

If the benefit in question amounts to a bribe, the provisions of the Bribery Act 2010 will apply. A bribe is defined as giving someone a financial or other advantage to encourage that person to perform their functions or activities improperly or to reward that person for having already done so. In *Novoship (UK) Ltd v Mikhaylyuk* (2012), the court explained that it would be a plain breach of the duty of loyalty for a fiduciary to accept a bribe. Such a recipient, together with those who dishonestly assist him, will be liable to account for their profits.

### **Remedies**

**14.83** The remedies for breach of directors' duties have not been incorporated into the statutory statement of directors' duties but, as we have seen, s 178(1) CA 2006 provides that the consequences of breach (or threatened breach) of ss 171 to 177 are the same as would apply if the corresponding common law rule or equitable principle applied. With respect to the no-conflict duty, it has long been settled that a director must disgorge any secret profit resulting from his breach of duty unless it was authorised (see s 175(4)(b) CA 2006, earlier). The liability to account arises even where the director acted honestly and where the company could not otherwise have

obtained the benefit (*Regal (Hastings) Ltd v Gulliver; IDC v Cooley*). In *Murad v Al-Saraj* (2005) Arden LJ explained the policy underlying such liability:

*It may be asked why equity imposes stringent liability of this nature . . . equity imposes stringent liability on a fiduciary as a deterrent—pour encourager les autres. Trust law recognises what in company law is now sometimes called the ‘agency’ problem. There is a separation of beneficial ownership and control and the shareholders (who may be numerous and only have small numbers of shares) or beneficial owners cannot easily monitor the actions of those who manage their business or property on a day to day basis. Therefore, in the interests of efficiency and to provide an incentive to fiduciaries to resist the temptation to misconduct themselves, the law imposes exacting standards on fiduciaries and an extensive liability to account.*

In *Coleman Taymar Ltd v Oakes* (2001), Robert Reid QC, sitting as a deputy judge of the High Court, stated that a company is entitled to elect whether to claim damages (equitable compensation) or an account of profits against a director who, by abusing his position, makes a secret profit. Where the director derives no personal financial benefit from the breach of duty, the court may award equitable compensation assessed by reference to any loss suffered by the company (*Breitenfeld UK Ltd v Harrison* (earlier)). Where, on the other hand, the director does derive a personal financial benefit, though the profit may arise out of the use of position as opposed to the use of trust property, the judges typically resort to the language of the ‘constructive trust’ as the means for fashioning a remedy (*Boardman v Phipps*, although, Lord Guest excepted, all of the judges spoke of the defendant’s liability to account). In *A-G for Hong Kong v Reid* (1992), Lord Templeman explained that *Boardman* ‘demonstrates the strictness with which equity regards the conduct of a fiduciary and the extent to which equity is willing to impose a constructive trust on property obtained by a fiduciary by virtue of his office’ (though some judges and commentators have doubted whether a constructive trust was actually imposed in *Boardman*, see, for example, Lewison J’s comments in *Sinclair Investments* (see para 14.85) and Penner (2016). And in *Chan v Zacharia I* (1983) Deane J stated in broad terms that ‘any

benefit or gain is held by the fiduciary as constructive trustee . . . and it is immaterial that there was no absence of good faith or damage [to the company]’.

**14.84** In *JJ Harrison (Properties) Ltd v Harrison* (2002) a director usurped a corporate opportunity by acquiring for his own benefit development land owned by the company. At the time of valuation he failed to disclose that planning permission was forthcoming which, once granted, would greatly inflate its value. The company, having unsuccessfully applied for planning permission a couple of years earlier, was unaware that local authority policy in this respect had changed. The director purchased the land from the company in 1985 for £8,400. Having obtained planning permission through, to add insult to injury, use of the company’s resources, he then resold part of it for £110,300 in 1988 and the rest in 1992 for £122,500. The director resigned and the company sought to hold him liable as a constructive trustee. Chadwick LJ, citing Millett LJ in *Paragon Finance plc v DB Thakerar & Co* (1999), said:

*It follows . . . from the principle that directors who dispose of the company’s property in breach of their fiduciary duties are treated as having committed a breach of trust that, a director who is, himself, the recipient of the property holds it upon a trust for the company. He, also, is described as a constructive trustee . . . The reason is that a director, on appointment to that office, assumes the duties of a trustee in relation to the company’s property. If, thereafter, he takes possession of that property his possession ‘is coloured from the first by the trust and confidence by means of which he obtained it’. The true analysis is that his obligations as a trustee in relation to that property predate the transaction by which it was conveyed to him.*

Chadwick LJ’s reasoning was applied by the Court of Appeal in *First Subsea Ltd v Balltec Ltd* (2018). – [2018] 1 BCLC 20 -

**14.85** In the *CMS Dolphin* case (see earlier), Lawrence Collins J subjected the issue of remedies for diverting a corporate opportunity to detailed analysis. He held that S was a constructive trustee of the profits referable to exploiting the corporate opportunity and, in general, it made no difference whether the opportunity is first taken up by the wrongdoer or by a ‘corporate vehicle’ established

by him for that purpose: ‘I do not consider that the liability of the directors in *Cook v Deeks* would have been in any way different if they had procured their new company to enter the contract directly, rather than (as they did) enter into it themselves and then transfer the benefit of the contract to a new company’. Further, the director is:

*accountable for the profits properly attributable to the breach of fiduciary duty taking into account the expenses connected with those profits and a reasonable allowance for overheads (but not necessarily salary for the wrongdoer), together with a sum to take account of other benefits derived from those contracts. For example, other contracts might not have been won, or profits made on them, without (eg) the opportunity or cash flow benefit which flowed from contracts unlawfully obtained. There must, however, be some reasonable connection between the breach of duty and the profits for which the fiduciary is accountable.*

The basis of a director’s liability in this situation is that, as seen in *Cook v Deeks*, the opportunity in question is treated as if it were an asset of the company in relation to which the director had fiduciary duties. He thus becomes a constructive trustee ‘of the fruits of his abuse of the company’s property’ (per Lawrence Collins J, earlier).

The decision in *Sinclair Investments (UK) Ltd v Versailles Trading Finance Ltd* (2011) is significant because the Court of Appeal has explained the distinction that should be drawn between personal liability to account for unauthorised profit as opposed to the Privy Council’s view in *Reid* that liability is proprietary. Lord Neuberger MR, delivering the leading judgment, held that a beneficiary of a fiduciary’s duties has no proprietary interest in any money or asset acquired by the fiduciary in breach of his duties, ‘unless the asset or money is or has been beneficially the property of the beneficiary or the trustee acquired the asset or money by taking advantage of an opportunity or right which was properly that of the beneficiary’, even if the fiduciary could not have acquired the asset had he not been a fiduciary. In finding that the appropriate remedy is an equitable account, the Court of Appeal did not follow the decision in *Attorney-General for Hong Kong v Reid* (1992), preferring its own decision in *Lister & Co v*

*Stubbs* (1890). The Master of the Rolls added that if it is a matter of equitable policy that a fiduciary should not be allowed to profit from his breach of duties, that can be achieved by extending or adjusting the rules relating to equitable compensation rather than those relating to proprietary interests. The judge explained that:

*[I]t seems to me that there is a real case for saying that the decision in Reid . . . is unsound. In cases where a fiduciary takes for himself an asset which, if he chose to take, he was under a duty to take for the beneficiary, it is easy to see why the asset should be treated as the property of the beneficiary. However, a bribe paid to a fiduciary could not possibly be said to be an asset which the fiduciary was under a duty to take for the beneficiary. There can thus be said to be a fundamental distinction between (i) a fiduciary enriching himself by depriving a Claimant of an asset and (ii) a fiduciary enriching himself by doing a wrong to the Claimant.*

(See also, *Cadogan Petroleum plc v Tolly* (2011).)

As Penner (2016) comments, the decision in *Sinclair* (and in *FHR*, discussed later) ‘draw[s] a distinction between those cases in which the asset which constitutes the unauthorised profit would have gone to the [company] but for its interception by the [director], and those cases in which the fiduciary enriches himself in the course of doing a wrong to the [company].’

The issue addressed in *Sinclair Investments* came before the Court of Appeal again in *FHR European Ventures LLP v Mankarious* (2013). While it acknowledged that it was bound to follow its own decisions in *Lister* and *Sinclair Investments*, the Court was clearly unhappy with this and urged the Supreme Court to consider whether *Sinclair* was ‘right to decide that *Lister* is to be preferred to *Reid*’. With considerable agility it distinguished the facts before it from *Lister* and held that a purchasing agent held a secret commission on constructive trust for its principal. The Court of Appeal’s call for final determination by the Supreme Court of the circumstances when a proprietary remedy (a constructive trust) will be imposed rather than a personal remedy (liability to account for a profit or bribe received in breach of duty) was answered in *FHR European Ventures LLP v Mankarious (No 2)* (2014) – [2014] UKSC 45. The Supreme Court took the

opportunity to lay the matter to rest by holding that a fiduciary who receives a bribe or secret commission in his capacity as a fiduciary holds the proceeds on constructive trust for his principal. Thus, any benefit which results from a breach of fiduciary duty to the company is held on trust for it. Lord Neuberger PSC expressed the view that this position at least has the advantage of clarity and certainty and is consistent with *Regal (Hastings)* and *Phipps*. It also has the advantage of ‘harmonising the development of the common law round the world.’ The consequence, as explained by Patten LJ in *First Subsea Ltd v Balltec* (above):

is that a constructive trust will be imposed on fiduciaries in such cases regardless of whether it is possible to treat the benefit or payment received by the agent as derived from property in which the principal had a pre-existing interest.

The imposition of a constructive trust can carry disastrous consequences for innocent third parties in circumstances where the defendant is bankrupt. It is, of course, right to strip a director of a gain made in breach of duty, but should that gain, without more, be regarded as representing trust property belonging to the company from the moment in time he received it? Although Lord Neuberger recognised the force of this argument, he thought it must be ‘balanced by the fact that it appears to be just that a principal whose agent has obtained a bribe or secret commission should be able to trace the proceeds of the bribe or secret commission into other assets and to follow them into the hands of knowing recipients (as in *Reid*).’

**14.86** As was commented in Chapter 13, the court, exercising its inherent jurisdiction, has the power to grant an equitable allowance to a fiduciary. In *Phipps v Boardman* (see earlier), the trustees who acted in breach of the no-conflict rule thereby created a handsome profit for the trust. They had acted honestly throughout and, though liable, were awarded an allowance on ‘a liberal scale’ to take account of their special expertise. Such an allowance may be awarded ‘if it was thought that justice between the parties’ so demands (*O’Sullivan v Management Agency and Music Ltd* (1985)). However, in the case of directors the scope of this jurisdiction has now been severely

limited following Lord Goff's remarks in *Guinness plc v Saunders* (see earlier) to the effect that it should be 'restricted to those cases where it cannot have the effect of encouraging the trustees [or directors] in any way to put themselves in a position where their interests conflict with their duties as trustees [or directors]'. Further, the House of Lords, mindful that the exercise of this discretion could constitute interference in company affairs, doubted whether it would ever be exercised in favour of a company director. Mindful of Lord Goff's speech in *Guinness*, Paul Morgan QC, sitting as a deputy judge of the High Court, in *Quarter Master UK Ltd v Pyke* (2005) stated that:

*I hold on the facts of the present case that the fundamental principle should prevail that a director is not to benefit from his breach of fiduciary duty and that no allowance is to be made.*

The judge concluded that the fact that the company would not itself have otherwise received the benefits which flowed from the breach made no difference (see also the remarks of Peter Smith J in *Crown Dilmun v Sutton* (2004)).

#### **Accessory liability**

##### **Knowing assistance**

**14.87** In certain circumstances those who assist a director in the course of a breach of duty will also be held liable for breach of fiduciary duty (see *Barnes v Addy* (1874), Lord Selborne LC). The test for determining dishonesty for the purposes of determining the liability of an accessory to the director's breach of duty (traditionally termed '*knowing assistance*') was formulated by Lord Nicholls in *Royal Brunei Airlines Sdn Bhd v Tan* (1995). He stated that dishonesty should be judged according to whether an honest person in the defendant's position would have acted in the way that the defendant acted. If he had acted in the same way, then the defendant will not be liable (see *Dubai Aluminium Co Ltd v Salaam* (1999); *Grupo Torras SA v Al-Sabah* (2001); and *Bank of Scotland v A Ltd* (2001); see further, Lewison J's survey of the case law in *Ultraframe (UK) Ltd v Fielding* (2005)). Lord Nicholls' objective test was considered by the House of Lords in *Twinsectra Ltd v Yardley* (2002). Confirming that the Privy Council's decision was also the law in England and Wales, the majority favoured a test of dishonesty that is neither purely

objective nor subjective but one which depends upon what Lord Hutton called the 'combined test'. This asks, first, whether the defendant's conduct was objectively dishonest by reference to the ordinary standards of reasonable people. If the answer is in the affirmative, the second step of the combined test is applied by determining whether there is evidence that the defendant realised that he had behaved dishonestly in the circumstances. Lord Hoffmann explained that the principles require more than simply showing dishonest conduct, '[t]hey require a dishonest state of mind, that is to say, consciousness that one is transgressing ordinary standards of behaviour'. The observations of Lord Hutton and Lord Hoffmann were considered in *Barlow Clowes International v Eurotrust International* (2005) PC, where the panel included Lord Nicholls and Lord Hoffmann. The Privy Council stated that it was unnecessary for the defendants to have considered what these ordinary standards of honest behaviour were, it was enough that the defendant was conscious of those parts of the transaction which rendered participation in it a breach of ordinary standards of honest behaviour. The panel also took the view that someone can be held to know or suspect that undertaking an act will render assistance in the misappropriation of funds even if that person is unaware that the funds are held on trust or, indeed, what a trust involves. Further, in response to the academic criticism that *Twinsectra* had changed the law by inviting enquiry not merely into the defendant's mental state about the nature of the transaction in which he was participating but also into his views about generally accepted standards of dishonesty, Lord Hoffmann explained that the principles laid down in *Twinsectra* were 'no different from the principles stated in *Royal Brunei*'. Accordingly, emphasis was given to the objective nature of the test for dishonest assistance.

### **Knowing receipt**

**14.88** In broad terms, the governing principle is that to establish liability in knowing receipt, the recipient must have actual knowledge (or the equivalent). Constructive knowledge is not enough (*In Re Montagu's Settlement Trusts* (1987)). The principle that arises in relation to knowing receipt in the context of companies was explained by Buckley LJ in *Belmont Finance Corp'n Ltd v Williams Furniture Ltd (No 2)* (1980) in the following terms:

*So, if the directors of a company in breach of their fiduciary duties misapply the funds of their company so that they come into the hands of some stranger to the trust who receives them with knowledge . . . of the breach, he cannot conscientiously retain those funds against the company unless he has some better equity. He becomes a constructive trustee for the company of the misapplied funds.*

The precise state of mind on the part of the recipient has generated considerable debate. In *BCCI Ltd v Chief Akindede* (2000), Nourse LJ, delivering the principal judgment of the Court of Appeal, held that there should be a single test for *knowing receipt*, namely that the recipient's state of knowledge had to make it *unconscionable* for him to retain the benefit of the receipt. Nourse LJ said:

*[J]ust as there is now a single test of dishonesty for knowing assistance, so ought there to be a single test of knowledge for knowing receipt. The recipient's state of knowledge must be such as to make it unconscionable for him to retain the benefit of the receipt.*

(See also *Houghton v Fayers* (2000); and *Charter v City Index Ltd* (2008).)

In *Thanakharn Kasikorn Thai Chamkat (Mahachon) v Akai Holdings Ltd* (2010), Lord Neuberger, sitting as a non-permanent Judge of the Court of Final Appeal of Hong Kong, took the view that the test of unconscionability was identical to irrationality (as in establishing want of authority). For example, the recipient might be irrational in believing that the fiduciary in question possessed apparent authority to commit the principal to hand over the asset, yet not be dishonest in believing or assuming he had that authority. His Lordship said:

*If the recipient's reliance on the alleged agent's apparent authority, when accepting the asset from the alleged agent on behalf of his principal, was dishonest or irrational, it seems to me that it would be unconscionable for the recipient to retain the asset . . . or, to put it another way, the recipient would have the relevant 'actual knowledge (or the equivalent)'.*

Lord Neuberger concluded the point by doubting whether negligent reliance would satisfy the unconscionability test. In *Otkritie International Investment Management Ltd v Urumov* (2014), a

further attempt at unravelling the meaning of unconscionability was made. Eder J, accepting counsel's submission on the point, said that:

*it is important to note that the test for knowledge in a knowing receipt claim is lower than it is for dishonest assistance: dishonesty is not a prerequisite of liability, and the question is whether the defendant had such knowledge as to render it unconscionable for the defendant to retain the benefit of the receipt . . .*

Citing *Snell's Equity*, the judge thought that in certain circumstances a defendant will be liable if he fails to make reasonable enquiries about the circumstances of the receipt: 'in gratuitous transactions, where the defendant has no reasonable justification to rely unquestioningly on the trustee's authority to transfer the property to him, it may be reasonable to impose a duty of inquiry on him. The recipient's knowledge of facts that would put a reasonable person on inquiry might amount to unconscionable knowledge . . . .'

It is noteworthy that Penner (2016) criticises the test of 'unconscionability' on the basis that it gives little or no guidance to a court attempting to delineate the appropriate degree of intent for the purposes of establishing liability. It is suggested that a single test for all accessory liability, whether knowing assistance or knowing receipt, in line with that stated in *Twinsectra* at least has the advantage of practicality and certainty.

**14.89** A significant case dealing with knowing receipt is *Brown v Bennett* (1999) where the Court of Appeal stressed that, to enforce a constructive trust on this ground, a claimant company had to show both a disposal of its property in breach of fiduciary obligation and beneficial receipt by the defendant of traceable property belonging to the company. Thus, liability for knowing receipt only arises where the property in question is transferred in breach of duty. A past breach of duty in relation to the company's property that has since been transferred does not necessarily render the recipient guilty of any dishonest receipt (see also Hoffmann LJ's judgment in *El Ajou v Dollar Land Holdings plc* (1994)).

**14.90** As is apparent from the decisions considered so far, the judges take the view that where a company's asset reaches the hands of an accessory it is impressed with a constructive trust (see, for

example, the reasoning of the judge in *Chard Hunt Investments Ltd v Hunt* (2017)). – [2017] EWHC 988 (Ch) This is logical where the asset in question is trust property. The issue that arises, however, is what is the appropriate remedy where company property does not reach the hands of a dishonest accessory given that, as Lord Nicholls recognised in *Royal Brunei*, liability as a dishonest assistant ‘is not dependent upon receipt of trust property [and] arises even though no trust property has reached the hands of the accessory’. Although in such situations the courts frequently resort to the ‘constructive trust’, it is suggested that what is meant is that the accessory’s liability to account is similar in nature. Indeed, Ungood-Thomas J in *Selangor United Rubber Estates Ltd v Cradock (No 3)* (1968) was moved to observe that the use of the term ‘constructive trustee’ in this context is ‘nothing more than a formula for equitable relief’. Thus, where no trust property is passed to the accessory, the company’s claim is personal not proprietary in nature (see *Houghton v Fayers* (2000), Nourse LJ; *Paragon Finance plc v DB Thakerar & Co* (1999), Millett LJ; *Belmont Finance Corp Ltd v Williams Furniture Ltd* (1979), Goff LJ; and *Bank of Scotland v A Ltd* (earlier), Lord Woolf CJ. See further Penner (2016), ch 11).

Finally, it should be noted that the company’s claim against any accessory is additional to its claim against the director. This is especially useful where the wrong-doing director has disappeared or is bankrupt.

### **Relief from liability**

**14.91** There are three ways in which a director who is in breach of duty may be relieved from liability:

(i) by obtaining the ‘consent, approval or authorisation’ by the members of the company under s 180; (ii) through ratification by the company under s 239; or (iii) by the court under s 1157.

### **Consent, approval, or authorisation by members**

**14.92** Section 180 sets out the circumstances in which members of the company may give their consent, approval, or authorisation (and when they are not required to do so), to a breach of a director’s general duties. Section 180(1)(a) and (b) provide that if the requirement of authorisation is complied with for the purposes of s 175 (see s 175(4) and (5), discussed earlier), or if the director has declared to the other directors his interest in a proposed transaction with the company under s

177: these processes replace the equitable rule that required the members to consent or authorise such breaches of duty. This is made subject to any enactment (for example, the transactions contained in Chapter 4 of Part 10, see para **14.93**) or any provision in the company's articles of association which requires the authorisation or approval of members (ss 180(1) and (3)). Compliance with s 177 (see paras 11.77 *et seq*) does not, therefore, mean that approval under Chapter 4 is dispensed with and vice versa. As Lord Goldsmith explained:

*Section 175 permits director authorisation of what would otherwise be impermissible conflicts of interest. Section 177 requires declarations of interest in proposed company transactions. In both those cases, the general duty no longer requires the consent of members.*

*The common law rules or principles that refer to the failure to have had a conflict of interest approved by the members of a company under certain circumstances need to be set aside. If they are not, although the Act provided that it was all right for there to be an authorisation, it might be suggested that the director should still be capable of being impeached by reference to this common law rule or principle. However, s 180(1) goes on to say: 'This is without prejudice to any enactment, or provision of the company's constitution, requiring such consent or approval'.*

*Certainly, the company's constitution can reverse the change and can insist on certain steps being taken requiring the consent of the members in certain circumstances. In that event, that provision would have to be given effect to. That is the consequence of the change of approach—and therefore a change of approach to the appropriate consequence of there not being members' approval in particular cases because it would no longer be required. (See, Official Report, 9/2/2006; coll GC337.)*

Section 180(2) goes on to provide that the general duties apply even though the transaction falls within Part 10, Chapter 4, of the CA 2006 (see later), except that there is no need to comply with ss 175 or 176 where the approval of members is obtained. Section 180(4) preserves the common law position on *prior* authorisation of conduct that would otherwise be a breach of the general

duties (ratification under s 239 necessarily takes place *after* the relevant conduct or omission, discussed later). In line with the case law on the issue, it is settled that the consent of the members must be fully informed (*Kaye v Croydon Tramways Co* (1898)); and members may give their unanimous consent informally (*Re Duomatic Ltd* (1969), see para **14.103**). However, members cannot authorise conduct that would be unlawful, a fraud on the company, or is dishonest (*Madoff Securities International Ltd v Raven* (2011)). Similarly, where the company is insolvent, or of doubtful solvency, members cannot authorise conduct which is prejudicial to the interests of creditors (*West Mercia Safetywear Ltd v Dodd* (see para **14.37**). As we saw in Chapter 10, where conduct has been previously approved or subsequently ratified, a member will not be permitted to bring a derivative claim against the director in question. This is because the effect of authorisation by the members is that the act in question becomes the act of the company (*Multinational Gas and Petrochemical Co Ltd v Multinational Gas and Petrochemical Services* (1983)). It is noteworthy that interested directors qua members can vote on a resolution to approve a prospective breach of the statutory duties under s 180, but cannot do so to ratify a breach after the event (see s 239(4), later). Finally, s 180(5) provides that subject to the other provisions in s 180, the general duties have effect notwithstanding any enactment or rule of law, except as otherwise provided or the context otherwise requires. This permits directors to make provision for employees under s 247 of the CA 2006 when the company ceases or transfers its business even if this would otherwise be a breach of the s 172 duty to promote the success of the company (see para 320, Explanatory Notes to CA 2006).

**14.93** As commented in the previous paragraph, Part 10, Chapter 4 of the CA 2006 lists certain transactions that require the approval of the members of the company. These include long-term service contracts (s 188); substantial property transactions (s 190); loans, quasi-loans, and credit transactions (ss 197–214); and payments for loss of office (ss 215–222)—(for the provisions relating to directors’ service contracts, see Chapter 13, para **13.27**). The policy underlying the requirement of shareholder approval of these specified transactions was explained by Carnwath J in *British Racing Drivers’ Club Ltd v Hextall Erskine & Co* (1997), who stressed that the possibility

of conflicts of interests in these circumstances is such that there is a danger that the judgment of directors may be distorted and so it ensures that ‘the matter will be . . . widely ventilated, and a more objective decision reached’. Section 180 thus sets out, in part, the relationship between the general duties of directors and these more specific provisions contained in Part 10, Chapter 4 of the Act. The requirements for approving long-term service contracts and payments for loss of office were discussed in Chapter 13. Here we outline the provisions dealing with substantial property transactions and loans, quasi-loans, and credit transactions.

### ***Substantial property transactions***

**14.94** Sections 190–196, which replace ss 320–322 of the CA 1985, require substantial property transactions involving the acquisition or disposal of substantial ‘non-cash assets’ by directors or connected persons (including shadow directors (s 223(1)(b)) to be approved in advance by the company’s members. A ‘substantial property transaction’ is defined as arising where the market value of the asset exceeds the lower of £100,000 or 10 per cent of the company’s net asset value if more than £5,000 (s 191). The principal features of the regime are:

- it permits a company to enter into a contract which is conditional on member approval. This implements a recommendation of the Law Commissions (s 190). The company is not to be liable under the contract if member approval is not forthcoming (s 190(3));
- it provides for the aggregation of non-cash assets forming part of an arrangement or series of arrangements for the purpose of determining whether the financial thresholds have been exceeded so that member approval is required (s 190(5));
- it excludes payments under directors’ service contracts and payments for loss of office from the requirements of these clauses (s 190(6)). This implements a recommendation of the Law Commissions;
- it provides an exception for companies in administration or those being wound up (s 193).

**14.95** The purpose of s 190 is to protect the company’s members. The requirement of approval by the general meeting may be satisfied informally under the *Duomatic* principle (see later), given that the members of the company make up the class the provision is designed to protect (see *Re*

*Duckwari plc (No 2)* (1998); *Wright v Atlas Wright (Europe) Ltd* (1999); *Re Conegrade Ltd* (2002)). Such informal consent must be unanimous. The remedies for breach are laid down by s 195 which provides that any arrangement or transaction entered into by a company in contravention of s 190 is voidable at the instance of the company (s 195(1)). The company's right to avoid the arrangement or transaction will, however, be lost if restitution is no longer possible, if the company has been indemnified, if rights to the property have been acquired by a bona fide third party for value without notice of the breach of s 190, or if the arrangement has, within a reasonable period, been retrospectively approved by the company (ss 195–196). Irrespective of whether the transaction is or can be avoided, the director or connected person and any other director who authorised the transaction will be liable to account to the company for any profit or loss sustained as a result of the breach of s 190. In *Re Duckwari plc (No 2)* (1998) and *Re Duckwari plc (No 3)* (1999) the Court of Appeal stated that to be recoverable the loss or damage had to result from the arrangement or transaction identified as falling within s 190; and the loss may be measured by reference to any depreciation in value of the asset acquired in contravention of the provision. The court was concerned with a transaction involving the acquisition of property rather than the borrowing or use of monies to finance its acquisition. The indemnity covered the difference between the purchase price and its proceeds of sale taking account of any expenditure incurred in increasing the property's value, but excluding the finance costs of the acquisition.

(See also, *Smithton Ltd v Naggar* (2013).)

#### ***Loans, quasi-loans, and credit transactions***

**14.96** The regulation of loans by companies to their directors dates back to the Companies Act 1948 and was severely tightened in the CA 1980 in order to address the growing problem identified in a series of DTI (now the Department for Business, Energy and Industrial Strategy) investigations of directors secretly directing money to themselves under the guise of loans on highly favourable terms from their companies (see the White Paper, *The Conduct of Company Directors* (Cmnd 7037, 1977)). In contrast to the CA 1985, ss 197–214 of the CA 2006 do not impose an absolute prohibition on loans to directors (including shadow directors, (s 223(1)(c)) and connected persons

but make such transactions subject to the approval of the company's members by resolution and, in certain circumstances, also subject to the approval by the members of its holding company. Further, there are no criminal sanctions for breach of the provisions but rather s 213 provides for civil consequences only and s 214 also provides for subsequent affirmation. The requirement for members' approval of loans apply to all UK registered companies with the exception of 'wholly-owned' subsidiaries (s 195(7)). The provisions relating to quasi-loans and credit transactions apply only to public companies and associated companies (ss 198–203).

**14.97** There are a number of exceptions to the requirement for members' approval which have been consolidated (see ss 204–209). These cover expenditure on company business (s 204); expenditure on defending proceedings etc (s 205); expenditure in connection with regulatory action or investigation (s 206); expenditure for minor and business transactions (s 207); expenditure for intra-group transactions (s 208); and expenditure for money-lending companies (s 209).

**14.98** The effect of a breach of ss 197, 198, 200, 201, or 203 is that the transaction or arrangement is voidable at the instance of the company (s 213(2)). Further, regardless of whether the company has elected to avoid the transaction, an arrangement or transaction entered into in contravention of the provision renders the director (together with any connected person to whom voidable payments were made and any director who authorised the transaction or arrangement) liable to account to the company for any gain he made as well as being liable to indemnify the company for any loss or damage it sustains as a result of the transaction or arrangement (s 213(4)). A director who is liable as a result of the company entering into a transaction with a person connected with him has a defence if he can show that he took all reasonable steps to secure the company's compliance with ss 200, 201, or 203.

**14.99** The Act does not define 'loan', although s 199 does define the term 'quasi-loan' and related expressions (see s 199). Some guidance was provided in *Champagne Perrier-Jouet SA v HH Finch Ltd* (1982) in which the court explained that a loan is a sum of money lent for a period of time to be returned in money or money's worth. In general, whether or not a payment to a director by the company is a loan for the purposes of s 197 as opposed to remuneration for work done is a fact-

intensive exercise. The distinction is not always obvious. In *Currencies Direct Ltd v Ellis* (2002) the defendant, a shareholder and director of the claimant company, received sums in cash or payment by way of expenses incurred by him. When he was excluded from the management of the company it sought repayment of £253,000 arguing that the sums were loans. The defendant argued that the money received was remuneration. The trial judge held that the company could only recover £43,117 that the defendant acknowledged was a loan, the balance being remuneration. The company's appeal to the Court of Appeal was dismissed. Mummery LJ stated that it is 'a misconception that a payment can only be properly characterised as remuneration if there is a specific agreement fixing the level or rate of remuneration or defining a formula for ascertaining a definite amount to be paid. The essence of remuneration is that it is consideration for work done or to be done . . . [it] may take different forms. It is not necessarily in the conventional form of a direct payment of a regular wage'. The evidence was plain, particularly the minutes of the board, that the payments were made as remuneration.

#### **Ratification of acts giving rise to liability**

**14.100** Section 239 puts the process of ratification by members of a breach of duty by directors onto a statutory footing. While broadly based on equitable rules, it imposes stricter requirements and s 239(7) makes it clear that to the extent that the statutory process is more lax, if at all, than the equitable rules and those in any enactment, then those rules prevail so as to supplement or increase the requirements laid down in the provision. Section 239(1) applies to the ratification by a company of conduct by a director 'amounting to negligence, default, breach of duty or breach of trust in relation to the company'. It therefore extends the ratification process to all breaches of the duties set out in the CA 2006, Part 10. It should also be recalled that ratification is also relevant to the court's consideration of whether or not to allow a derivative claim to succeed under s 263 (see Chapter 10).

**14.101** The notice convening the members' meeting must state in explicit terms the purpose for which the meeting is being called in so far that it must provide a 'fair, candid, and reasonable explanation' of the business proposed (*Kaye v Croydon Tramways Co* (1898)). Failure to comply with this requirement will result in the resolution, if passed, being held ineffective as against those

shareholders who dissented or who were absent from the meeting.

**14.102** Section 239(2) provides that the decision of the company to ratify such conduct *must* be made by a resolution of the members. This appears to be based on the equitable rule noted by Lord Russell in *Regal (Hastings) Ltd v Gulliver* (see earlier), that the directors ‘could, had they wished, have protected themselves by a resolution . . . of the Regal shareholders in general meeting’. On the other hand, where a director has fraudulently expropriated a company asset, the breach is non-ratifiable (*Cook v Deeks* (see earlier)).

**14.103** Sections 239(3) and (4) provide that the ratification is effective only if the votes of the director (qua member) in breach (and any member connected with him) are disregarded. This changes the pre-existing law (see, for example, *North-West Transportation Co Ltd v Beatty* (1887)), by disenfranchising the defaulting director. Section 239(6) provides that nothing in the provision affects the law on unanimous consent. This presumably means that the restrictions in s 239(3)–(4) on who may vote on a resolution will not apply when every member (including a director qua shareholder) votes, whether by informal means or otherwise, in favour of the resolution. In this regard it is settled that a breach of duty is ratifiable by obtaining the informal approval of *every* member who has a right to vote on such a resolution (*Re Duomatic Ltd* (1969)). The *Duomatic* rule only applies where unanimous consent can be shown to exist, it will not validate majority decisions made informally (see *Knopp v Thane Investments Ltd* (2002) and *Extrasure Travel Insurances Ltd v Scattergood* (earlier); further, members must have full knowledge of the circumstances surrounding the breach and be aware of the fact that their assent is being sought: (*Kaye v Croydon Tramways Co* (1898); and *EIC Services Ltd v Phipps* (2003)). In *Sharma v Sharma* (2013), Jackson LJ, applying *Re Home Treat Ltd* (1991), stressed that if the shareholders with full knowledge of the relevant facts *acquiesce* in the director’s proposed conduct, then that may constitute consent (emphasis added).

#### **Relief from liability**

**14.104** Section 1157 of the CA 2006, which replaces s 727 of the CA 1985, confers on the court the discretion to relieve, in whole or in part, an officer of the company from liability for negligence,

default, breach of duty, or breach of trust where it appears to the court that the officer has acted *honestly and reasonably* and that, having regard to all the circumstances of the case, he ought fairly to be excused on such terms as the court thinks fit. Although there is relatively little case law on the provision, some parameters surrounding the type of conduct for which relief will be denied have emerged. The courts will not grant relief where directors have abused their position for financial gain. In *Neptune (Vehicle Washing Equipment) Ltd v Fitzgerald (No 2)* (1995), a sole director, in breach of his fiduciary duties, had secured company resolutions in order to obtain the payment to himself of £100,892 for the termination of his service contract. He could not be said to have acted reasonably. Similarly, relief was refused in *Guinness plc v Saunders* (1990), on the basis that it was out of the question to relieve a director who retained £5.2m paid to him, allegedly by way of remuneration, under a void contract. In *Re Duckwari plc (No 2)* (1998), the point was made *obiter* that a director who intends to profit by way of a direct or indirect personal interest in a substantial property transaction could not be said to have acted reasonably and therefore would be denied relief under s 1157. Further, the discretion to relieve a director from liability will not be exercised merely because of the absence of any finding of bad faith or actual conflict and the absence of quantifiable loss by the company or because of the negligible profit to the defendant director (per Mummery LJ in *Towers v Premier Waste Management Ltd* (2011); applied in *McGivney Construction Ltd v Kaminski* (2015), Lord Wollman).

**14.105** The section requires a director seeking relief from liability to prove honesty and reasonableness. In *Re Welfab Engineers Ltd* (1990), the directors of a company which had been trading at a loss sold its principal asset for the lower of two competing bids on the understanding that the company would continue to be run as a going concern. Shortly afterwards the company went into liquidation and the liquidator brought misfeasance proceedings against the directors. It was held that the directors had not acted in breach of duty in accepting the lower offer but, even if they had, it was a case in which relief would be granted under s 1157. Hoffmann J took the view that the directors were motivated by an honest and reasonable desire to save the business and the jobs of the company's employees.

**14.106** The requirement of reasonableness contained in s 1157 has presented the judges with the apparent conundrum of finding negligent conduct reasonable. The judicial response appears to suggest a willingness to dilute the objective character of the concept of reasonableness when determining the availability of relief. This is particularly discernible in Hoffmann LJ's judgment in *Re D'Jan of London Ltd* (1994), where he fashioned a solution based upon a subjective consideration of the director's conduct. A straightforward proposal form for property insurance contained numerous factual errors. The insurers subsequently repudiated liability on the policy when the company claimed for fire damage. The controlling director had signed the proposal without reading it. Hoffmann LJ thought that it was the kind of mistake that could be made by any busy man. In granting the director partial relief from liability, the court had regard to the fact that he held 99 of the company's shares (his wife held the other), and therefore the economic reality was that the interests the director had put at risk were those of himself and his wife. The judge observed:

*It may seem odd that a person found to have been guilty of negligence, which involves failing to take reasonable care, can ever satisfy the court that he acted reasonably. Nevertheless, the section clearly contemplates that he may do so and it follows that conduct may be reasonable for the purposes of section 727 [now s 1157] despite amounting to lack of reasonable care at common law.*

**14.107** Similarly, in *Re Brian D Pierson (Contractors) Ltd* (2001), Hazel Williamson QC, sitting as a deputy High Court judge, applying *Re D'Jan of London Ltd* observed that '“reasonableness” for the purpose of s 1157 must be meant to be capable of being satisfied by something less than compliance with the common law standard of care in negligence' (see also, *Re Paycheck Services 3 Ltd* (2009)). The reasoning in these decisions discloses that the court can take into account considerations such as directors favouring corporate stakeholders, and the degree of culpability of his or her conduct when determining whether or not it is reasonable and therefore excusable. In the latter type of case, an honest but negligent director might therefore be relieved from liability provided the negligence in question was not gross but the kind of thing that could happen to any busy person (*cf Dorchester Finance Co Ltd v Stebbing* (1989)). Complete inactivity as a director is

clearly unreasonable and cannot, therefore, be enlisted for the purposes of s 1157 to support the contention that the director had acted honestly and reasonably (*Lexi Holdings plc (in admin) v Luqman* (2007); see also, *Re Brian D Pierson (Contractors) Ltd* (see earlier)). Subjectivity also significantly and peculiarly coloured the interpretation of s 1157 by the trial judge in *Re Simmon Box (Diamonds) Ltd* (2000). Peter Smith QC, sitting as a deputy judge of the Chancery Division, expressed the view that s 1157 is designed to achieve fairness as between wrongdoers. The judge thought it fair to grant partial relief to a 19-year-old director against the consequences of the actions, which were not caused by any direct fault on his part, but arose from the conduct of his father in whom he reposed too much trust. In the event, relief became irrelevant because the Court of Appeal found that the director was not liable at all (*Cohen v Selby* (2001)). In *Hedger v Adams* (earlier), the court expressed the view that had the director been found liable for breach of duty it would have relieved him from liability because he had followed professional advice. Having taken professional advice, there was no doubt that the defendant had been acting honestly and reasonably (see also, *Re Finch (UK) plc* (earlier)); but note, claims for relief where it is argued that professional advice had been followed will depend upon whether full disclosure to the professional had been made, see the reasoning of the judge in *Chard Hunt Investments Ltd v Hunt* (above), where the defendant director argued that he had acted on the liquidator's advice).

**14.108** However, Lord Hoffmann's subjective approach has been challenged. In *Bairstow v Queens Moat Houses plc* (2001), the directors, acting on the company's 1991 accounts that incorrectly showed inflated profits, unlawfully paid dividends which exceeded the available distributable reserves (see Chapter 7). Robert Walker LJ refuted the notion that reasonableness is capable of being satisfied from an essentially subjective point of view (see also *Re MDA Investment Management Ltd; Whalley v Doney* (2005); *Re Loquitur Ltd; IRC v Richmond* (2003); cf *Inn Spirit Ltd v Burns* (2002)). A similar view was also expressed by the judge in *Coleman Taymar Ltd v Oakes* (2001), although relief was granted in respect of the account of profit arising from a breach of fiduciary duty where, it will be recalled, the director had honestly and reasonably launched another company as a competitor while still technically a director of, but after the termination of his

employment with, Coleman Taymar Ltd.

**14.109** The issue of relief has also come to the fore in relation to the wrongful trading provision, s 214(1) of the Insolvency Act 1986 (see Chapters 3 and 17). By way of defence to such a claim, s 214(3) provides that the court will not hold a director liable if, once he found himself in a position where he knew or ought to have known that the company was going into insolvent liquidation he took every step with a view to minimising the potential loss to the company's creditors. The facts which a director ought to know or ascertain for the purposes of s 214(3) are determined predominantly by way of objective assessment (s 214(4) refers to 'a reasonably diligent person' as the principal criterion). In *Re Produce Marketing Consortium Ltd* (1989), Knox J examined the interrelationship between s 1157 and the wrongful trading provision. He took the view that s 214 contains sufficient safeguards for the protection of directors and that the provision could not be easily accommodated with the 'essentially subjective approach that section 1157 . . . requires'. In *Re Brian D Pierson (Contractors) Ltd* (see earlier), the court held that s 1157 did not apply to a wrongful trading claim because Parliament did not intend both s 214 and s 1157 of the several Acts to be operated by the same judge at the same time.

#### **FURTHER READING**

This chapter links with the materials in Chapter 12 of *Hicks and Goo's Cases and Materials on Company Law*, (Oxford, OUP, 2011, xl+649p).

Birks, 'The Content of Fiduciary Obligation' [2002] *TLI* 34.

Conaglen, 'The Nature and Function of Fiduciary Loyalty' [2005] *LQR* 452.

Edelman, 'When do Fiduciary Duties Arise?' [2010] *LQR* 302.

Edmunds and Lowry, 'The Continuing Value of Relief for Directors' Breach of Duty' [2003] *MLR* 195.

Etherton, 'The Legitimacy of Proprietary Relief' [2014] *Birkbeck LR* 59.

Elliott and Mitchell, 'Remedies for Dishonest Assistance' [2004] *MLR* 16.

Finch, 'Company Directors: Who Cares about Skill and Care' [1992] *MLR* 179.

Grantham, 'The Unanimous Consent Rule in Company Law' [1993] *CLJ* 245.

Ho, 'Bribes and the Constructive Trust as a Chameleon' [2012] *LQR* 485.

Kershaw, 'Lost in Translation: Corporate Opportunities in Comparative Perspective' [2005] *OJLS* 603.

Lim, 'Directors Fiduciary Duties: A New Analytical Framework' [2013] *LQR* 242.

Lowry, 'Self-Dealing Directors—Constructing A Regime of Accountability' [1997] *NILQ* 211.

Lowry, 'Judicial Pragmatism: Directors' Duties and Post-resignation Conflicts of Duty' [2008] *JBL* 83.

Lowry, 'The Duty of Loyalty of Company Directors: Bridging the Accountability Gap Through Efficient Disclosure' [2009] *CLJ* 607.

Lowry, 'The Irreducible Core of the Duty of Care, Skill and Diligence of Company Directors' [2012] *MLR* 249.

Lowry and Edmunds, 'The Corporate Opportunity Doctrine: The Shifting Boundaries of the Duty and its Remedies' [1998] *MLR* 515.

Lowry and Edmunds, 'Of Resigning Directors: Lessons in Reform' [2013] *HKLJ* 55.

Penner, *The Law of Trusts* (Oxford, OUP, 2016), Chapter 12.

Prentice, 'The Corporate Opportunity Doctrine' [1974] *MLR* 464.

Riley, 'The Company Director's Duty of Care and Skill: The Case for an Onerous but Subjective Standard' [1999] *MLR* 697.

Sealy, 'The Director As Trustee' [1967] *CLJ* 83.

Teele Langford, 'The Duty of Directors to Act Bona Fide in the Interests of the Company: A Positive Fiduciary Duty? Australia and the UK Compared' [2011] *JCLS* 215.

Watts, 'Tyrrell v Bank of London—an inside look at an inside job' [2013] *LQR* 527.

Worthington, 'Reforming Directors' Duties' [2001] *MLR* 439.

### **SELF-TEST QUESTIONS**

- 1 When directors exercise their duties on behalf of the company, whose interests are they required to consider?
- 2 A company is in need of additional capital. The board decides to issue additional shares and

makes an allotment to an existing shareholder, X. It does so in preference to another shareholder, Y, who has created difficulties for the board by insisting that the company pursue ethical policies and whose shareholding the board now wishes to dilute.

Advise Y who wishes to have the allotment set aside.

**3** Arthur is the managing director of Apex plc, a large computer technology company. In recent years the company has enjoyed record levels of profitability. It is generally recognised that the company's success is due to Arthur's technical expertise and management skills. The articles of association of Apex plc provide:

90. Remuneration of directors. The board shall fix the annual remuneration of the directors provided that without the consent of the company in general meeting such remuneration shall not exceed the sum of £1,000,000 per annum.

91. The board may, in addition to the remuneration authorised in article 90, grant special remuneration to any director who serves on any committee of the company.

In the past 12 months, the following events have occurred:

(i) Arthur is paid £1 million consultation fee for successfully guiding Apex plc through its takeover of Xon Ltd, a competing business. This payment was agreed by a special committee of the Apex plc board constituted to advise the main board on mergers and acquisitions.

(ii) Arthur forms a private company, Macro Electronics Ltd, which develops software programs for computers. Arthur places large orders with Macro Electronics Ltd without informing Apex plc of his interest in the company.

(iii) Arthur is approached by Bsquare Corporation, a large US company, with the offer to enter into a joint venture with them in order to develop a revolutionary word processing program. Arthur resigns his post with Apex plc and accepts the offer. He makes a handsome profit. Apex plc has recently been taken over by Ytel plc. The details of the events outlined above have now come to the notice of the board of Ytel plc. They wish to pursue any claims they may have against Arthur.

Advise the board of Ytel plc.

- 4 Are the duties of directors too stringent?
- 5 'The statutory statement of directors' duties contained in the CA 2006 does little to clarify or simplify the confused state of the case law'. Discuss.